

**OFFICIAL TRANSCRIPT OF PROCEEDINGS  
BEFORE THE  
POSTAL RATE COMMISSION**

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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

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In the Matter of: )  
 )  
RATE AND SERVICE CHANGES )  
TO IMPLEMENT FUNCTIONALLY ) Docket No. MC2004-4  
EQUIVALENT NEGOTIATED SERVICE )  
AGREEMENT WITH DISCOVER )  
FINANCIAL SERVICES, INC. )

VOLUME #2  
MATERIALS INCORPORATED INTO THE RECORD

Date: September 10, 2004  
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Pages: 27 through 241

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**ORIGINAL**

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**Discover Financial Services, Inc.**

**Karin Giffney  
(DFS-T-1)**

DFS-T-1

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

## Rate And Services Changes To Implement Functionally Equivalent Negotiated Service Agreement With Discover Financial Services, Inc.

Docket No. MC2004-4

DIRECT TESTIMONY  
OF  
KARIN GIFFNEY  
ON BEHALF OF  
DISCOVER FINANCIAL SERVICES, INC.

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Counsel for Discover Financial Services,  
Inc.

June 21, 2004

1                                   **Direct Testimony of**  
2                                   **Karin Giffney, Discover Financial Services, Inc.**

3                                   **Introduction**

4                   My name is Karin Giffney. I am Vice President of Marketing for Discover  
5   Financial Services, Inc. (DFS). DFS is a business unit of Morgan Stanley and is  
6   responsible for the operation of the Discover® Card brand. DFS offers a variety  
7   of Discover branded credit cards and other financial services to meet the needs  
8   of our customers. As one of the largest issuers of general purpose credit cards  
9   in the U.S., we are a direct competitor of Capital One.

10               As provided in the Commission's new Negotiated Service Agreement  
11   (NSA) rules, DFS is appearing before the Commission as a co-proponent with  
12   the Postal Service of a Functionally Equivalent NSA. Our NSA generally  
13   encompasses the same or analogous terms and conditions of the Capital One  
14   NSA and is consistent with DMM §911. This NSA does not encompass the mail  
15   of the brokerage business of our parent company, Morgan Stanley. We look  
16   forward to a thorough and prompt review, pursuant to the time limits of the  
17   Commission's rules, and pledge our full cooperation with the Commission in this  
18   process.

19               I have worked in direct marketing for 24 years, primarily in financial  
20   services. I was part of the original marketing team that launched the Discover  
21   Card in 1986 and have held a variety of marketing positions. My previous areas  
22   of responsibility include fee products, cash advance and investment product  
23   marketing, card activation and retention, and credit card promotion and

1 sponsorships. In my current role I manage four departments: Production  
2 Services, Creative Services, Telemarketing, and Contact Management Strategy.  
3 I procure the majority of external marketing services for DFS.

4 I am an active member of the Direct Marketing Association (DMA) and  
5 serve as a judge in DMA's Echo Award direct mail competition. I also recently  
6 received the "Woman of the Year" award from Women in Direct Marketing  
7 International, Inc. I am also a member of the Chicago Association of Direct  
8 Marketing, and have lectured on direct marketing principles at several  
9 universities in Illinois.

### 10 **Purpose of My Testimony**

11 The purpose of my testimony is to provide the Commission with  
12 background about DFS and to discuss in general terms our marketing practices  
13 as they relate to mail operations. In addition, I will give our "before-NSA" and  
14 "after-NSA" First-Class Mail volume projections. In discussing our marketing  
15 practices, I trust the Commission accepts that I cannot reveal proprietary  
16 information. The credit card industry is highly competitive, and too much insight  
17 into the specifics of our marketing strategies would give our competitors a  
18 significant and unfair advantage. With that in mind, this testimony provides  
19 insights into economic factors, industry trends, and company practices that  
20 influence the selection of marketing channels and our mail forecasts.

### 21 **Discover Financial Services**

22 DFS is one of the largest issuers of general purpose credit cards in the  
23 U.S., with more than 50 million Cardmembers. We offer a variety of credit cards

1 to meet the needs of our customers, including the Discover Classic Card, the  
2 Discover Gold Card, the Discover Platinum Card, The Miles Card from Discover  
3 Card, and an array of affinity cards. When the Discover Card was launched in  
4 1986, DFS pioneered many card features that since have spread throughout the  
5 credit card industry—no annual fee, 24/7 customer service, and the Cashback  
6 Bonus® award.

7 DFS also offers additional services such as Discover CDs and Money  
8 Market Accounts, auto insurance, and home loans. DFS owns and operates its  
9 own merchant network (the Discover/NOVUS® Network), which processes credit  
10 card transactions, much in the same way that the Visa, MasterCard, and  
11 American Express networks do.

12 DFS is also proud to support a wide variety of philanthropic programs and  
13 organizations. These include Juvenile Diabetes Research Foundation  
14 International, Boost, Make a Wish Foundation, Communities in School, and the  
15 Discover Card Tribute Award Scholarships.

16 Over the years, the industry has recognized Discover Card many times  
17 and we have received numerous awards. In 2003, we won the Brand Keys  
18 Customer Loyalty Award in the credit card category for the sixth consecutive  
19 year. Further, the Discover 2GO<sup>SM</sup> Card, the first key chain credit card in the  
20 industry, was recognized as "One of the Best Products of 2002" by *Business*  
21 *Week* and *USA Today*. DFS is also a leading credit card company on the  
22 Internet, with more than 12 million Cardmembers registered at the Discover Card  
23 Account Center, accessible at [www.discovercard.com](http://www.discovercard.com).

## **Functionally Equivalent NSAs**

DFS is pleased to see that the Postal Service and the Commission have opened up the area of NSAs and we anticipate that this new pricing mechanism will provide mutual benefits to both the Postal Service and the mailing community. For this pricing mechanism to be a success, the Commission must ensure that competitors of a company benefiting from an NSA, competitors both large and small, can straightforwardly receive a Functionally Equivalent NSA. In this regard, both the speed and flexibility of the process will be critical to the success of the process.

Since no two companies are alike, the Commission and the mailing community should expect that Functionally Equivalent NSAs will not be mirror images of a baseline NSA. Inevitably they will reflect differences between companies' operations, practices, structures, goals, and marketing philosophies, as our NSA demonstrates.

## **DFS's Approach to Marketing and the Mail**

DFS assesses the viability of its marketing strategies on an ongoing basis. We do so by evaluating the efficiency of various marketing channels, and strive to use those that are most productive. While mail provides many benefits, this channel does face increasing competition. DFS utilizes a variety of marketing channels: telemarketing, event marketing, and merchant marketing, as well as print, television, radio, and outdoor advertising. We also use email and the Internet.



1           Still, direct mail remains a part of our core strategy and we expect to  
2   continue using this channel in our marketing efforts. Direct mail is a proven and  
3   highly viable channel for reaching both customers and prospects. Mail provides  
4   DFS with the ability to quickly and cost-efficiently reach large numbers of  
5   households, yet gives us the flexibility to target specific consumers with  
6   appropriate offers. With the personalization that mail technology provides, mail  
7   allows us to test many offers at one time and create multiple versions of each  
8   offer. In sum, mail is a robust marketing vehicle in which we can test myriad  
9   offers and products simultaneously.

#### 10                                   **DFS's Use of the Mail**

11           DFS uses both First-Class Mail and Standard Mail. Our total mail volume  
12   is comprised of two types: Operations and Marketing Mail. Our Operations Mail,  
13   which is always sent First Class, includes all business-related correspondence  
14   directed to both our Cardmembers and the merchants that participate in the  
15   Discover/NOVUS Network, e.g., Cardmember and merchant statements.

16           While some of our Marketing mail is currently sent First Class, the bulk is  
17   sent Standard Mail. We have concluded that under this NSA there would be an  
18   advantage, depending upon certain characteristics of the addressees, to shift a  
19   portion of our monthly campaign mail from Standard Mail to First-Class Mail. The  
20   speed and likelihood of delivery, as well as the forwarding capability inherent in  
21   First-Class Mail, are valuable components of our marketing program.

22           Each month DFS creates acquisition marketing campaigns, which mail on  
23   a weekly basis, to acquire new Cardmembers. Each campaign consists of

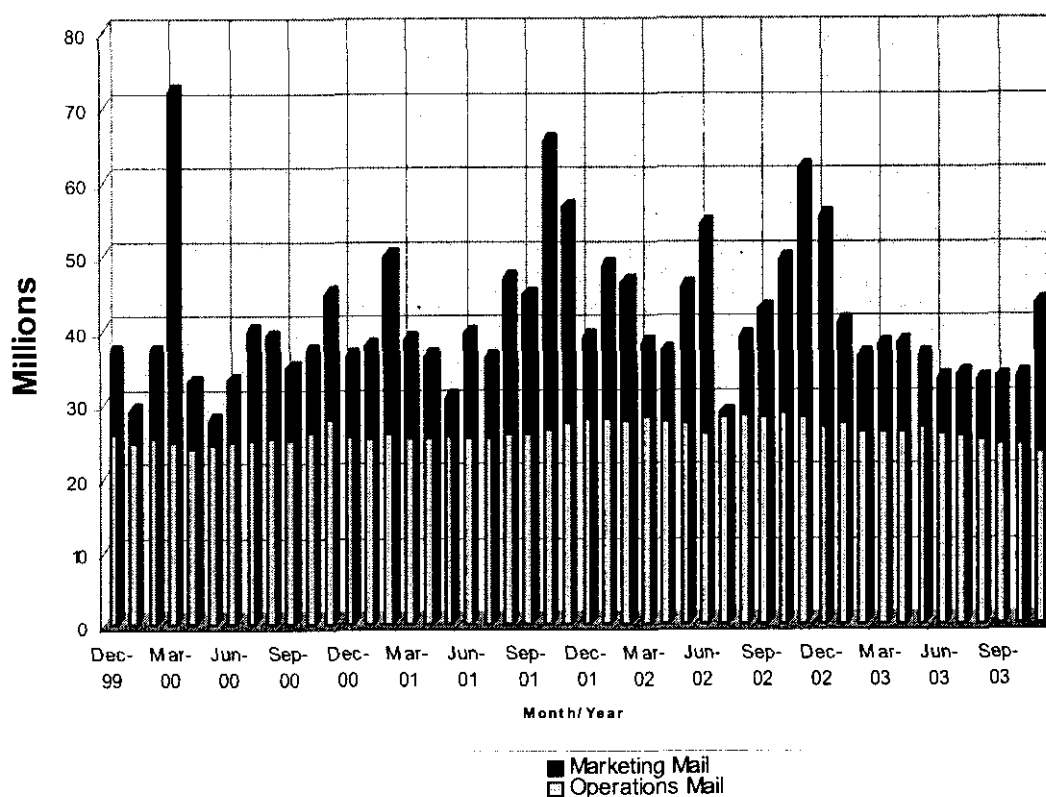
1 various offers mailed from contracted lettershops and presort suppliers located  
2 primarily in the Midwest. The mailings in each campaign range in size from very  
3 small volumes (generally marketing tests) to very large volumes. The campaigns  
4 are typically planned well in advance and often incorporate new features,  
5 promotions, and creative tests. Our respective marketing areas analyze the  
6 results of each campaign.

7       On a monthly basis, DFS procures over 40 mailing lists that make up the  
8 entire acquisition campaign mailing. We mail from these lists and not from an  
9 internal prospect database. Once lists are obtained, we use statistical analysis to  
10 select the best offers and pricing that would be of value to new Cardmembers.  
11 We balance response modeling and risk analyses in an effort to obtain profitable  
12 new accounts. DFS markets on a monthly basis to its portfolio through a contact  
13 management and segmentation strategy in an effort to provide additional  
14 services and meet its Cardmembers' needs.

## DFS's Historic Mail Volumes

While the volume of our Operations Mail tends to be stable, our Marketing Mail volumes fluctuate, although that fluctuation has recently moderated. The following graph shows our First-Class Mail volumes for both Marketing and Operations Mail for December 1999 through our FY 2003 fiscal year. The data upon which this graph is plotted are found in Appendix I.

**FY 2000-2003 Monthly First-Class Mail Volume (Pieces)**



## DFS's Budgeting Process

Our annual budget process begins with a strategic plan that provides direction and key drivers, including a new account goal for the period. Economic factors, current market conditions, and other business developments are considered as the plan is developed. As we develop a budget pursuant to the plan, we use recent performance data and we identify common industry trends such as declining response and approval rates, consumer's debt capacity, debt consolidation, and consumer usage. Once drafted, the budget is approved by DFS's Senior Management and then by Morgan Stanley. It is the Marketing Department's responsibility to manage its budget within a one percent variance each month. Consequently, we manage the marketing budget extremely tightly, and this discipline is critical to the success of our business.

## Three-Year Forecast, Before- and After-NSA

DFS's current three-year forecast, which reflects our use of other channels including electronic communications, for First-Class Mail is:

### Before-NSA Forecast (millions)

	Year One	Year Two	Year Three
Marketing	156	156	156
Operations	295	290	285
Total	451	446	441

As these numbers show, our First-Class Marketing Mail projections for the next three years are essentially flat, notwithstanding a recent reported industry trend towards lower First-Class Marketing Mail volumes. See DM News "Fewer

1 Credit Card Offers Mailed for 2<sup>nd</sup> Consecutive Year,” April 1, 2004 at [www.dnnews.com/cgi-bin/artprevbot.cgi?article\\_id=20720&dest=article](http://www.dnnews.com/cgi-bin/artprevbot.cgi?article_id=20720&dest=article). See also  
 2  
 3 [www.postalwatch.org/news\\_2004\\_01.htm](http://www.postalwatch.org/news_2004_01.htm).

4 We have projected our after-NSA First-Class Mail volumes, which still  
 5 reflect our use of other channels including electronic communications, to be:

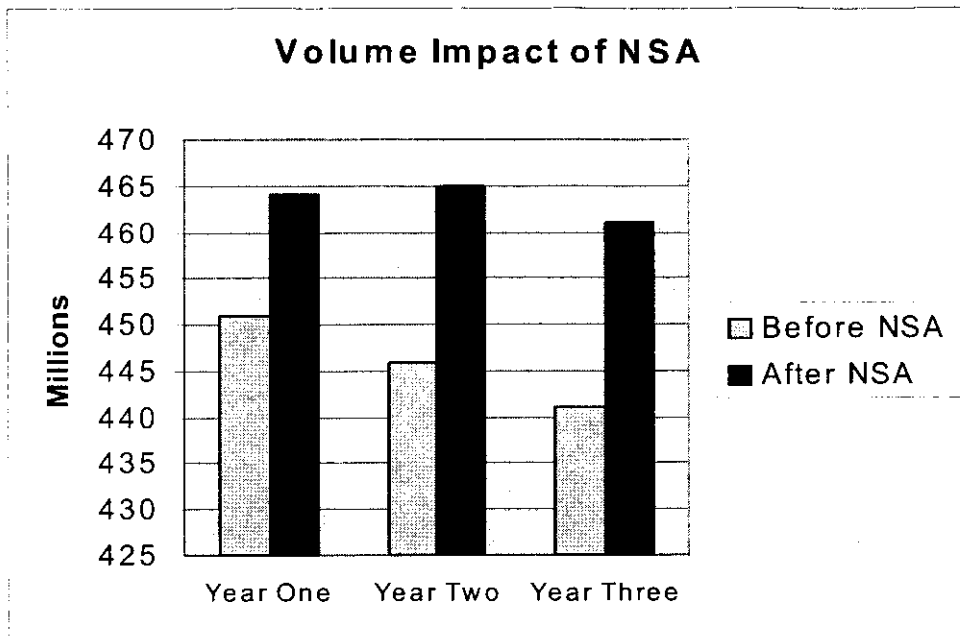
6

	Year One	Year Two	Year Three
Marketing	169	174	174
Operations	295	291	287
Total	464	465	461

7

8 As explained below, we view this projection as a minimum for it is based  
 9 upon an upgrade from Standard to First-Class Mail for existing marketing  
 10 campaigns, and does not project any “new” marketing campaigns that would use  
 11 First-Class Mail. While we are confident that the lower rates will incent us to use  
 12 mail when we create new marketing campaigns, we believe that we cannot  
 13 accurately project the level of such new volume at this time. Hence, our  
 14 projection is a minimum projection that encompasses only the Standard to First-  
 15 Class Mail upgrade.

16 Even with this minimum projection, the Postal Service should profit from  
 17 this NSA. An additional 8.33% in First-Class Marketing Mail volume will be  
 18 generated in the first year, and an additional 11.54% in First-Class Marketing  
 19 Mail volume will occur in years two and three, as shown in the following graph.



## Explanation of Marketing and Operations Mail Forecasts

**Marketing Mail Before-NSA Volumes.** DFS's before-NSA volume projection is 156 million for each of the next three years.

As explained earlier, DFS uses a variety of marketing channels in its marketing mix and our First-Class Marketing Mail volume, which recently has been relatively flat, reflects that. This trend continues in our first year's forecast, which is an actual budgeted figure. Moreover, unless the cost structure for mail becomes more attractive, this trend will continue in years two and three, as alternate channels increasingly are considered by DFS. Therefore, absent the NSA, we expect that our First-Class Marketing Mail volume will remain at 156 million in years two and three.

**Marketing Mail After-NSA Volumes.** DFS's after-NSA volume projection is that First-Class Marketing Mail will increase by 13 million in the first year, to yield a year-one volume projection of 169 million. DFS expects that its Marketing

1 Mail will increase by an additional 5 million the second year and remain at that  
2 level the third year. This yields volume projections of 174 million for both years  
3 two and three. As noted above, these are minimum projections for they are  
4 based solely upon upgrading Standard-Mail volumes to First Class. The discount  
5 provided under the NSA increases the attractiveness of First-Class Mail for  
6 certain acquisition segments, particularly in view of the forwarding, speed,  
7 likelihood of delivery, and perceived value of First-Class Mail.

8 In addition, DFS recognizes that lower NSA rates will improve mail's edge  
9 in our decision-making process when we consider which channels to use in new  
10 marketing campaigns, and inevitably yield greater First-Class Mail volumes from  
11 these new campaigns. However, DFS at this time cannot accurately project the  
12 First-Class Mail growth for such new mail campaigns in years two and three.  
13 Thus, we believe these First-Class Marketing Mail projections are minimums.

14 **Operations Mail Before-NSA Volumes.** DFS's before-NSA volume  
15 projection for Operations Mail for year one is 295 million pieces. This is based  
16 on the number of Cardmember and merchant accounts, as well as the number of  
17 mailings to each. As set forth in Morgan Stanley's Form 10-K for fiscal year  
18 2003, DFS intensified its focus on the quality of its credit card loan portfolio. We  
19 expect this focus to continue in 2004 and thereafter. It is designed to eliminate  
20 some lower quality accounts and increase higher quality accounts. We expect  
21 this intensified focus on quality, along with an increased number of merchants  
22 and Cardmembers receiving electronic statements, will likely result in a decline in  
23 Operations Mail volume of approximately 5 million for each of years two and

three. This yields an Operation Mail volume projection of 290 million in year two and 285 million in year three.

**Operations Mail After-NSA Volumes.** DFS's after-NSA volume projection for Operations Mail for year one remains at 295 million. This projection is the same as our before-NSA projection because any impact on Operations Mail volume from increased marketing will not likely be seen until year two.

DFS expects that increased marketing under the NSA will grow high quality accounts at a faster rate for years two and three. This increase in high quality accounts will produce an additional 1 million pieces of Operations Mail per year for each of the years, thus reducing the net decline for both years from 5 million to 4 million. These figures produce a net total volume projection for Operations Mail of 291 million in year two and 287 million in year three.

### **The Competitive Cap and Address Quality Issues.**

**Competitive Cap.** The DFS NSA includes a three-year cap of \$13 million. This is a competitive cap, proportionate to that set forth in the Capital One NSA. In principle, DFS does not see the need for any cap since the Postal Service will generate additional profit from the increased volume and since we have agreed to an adjustable threshold.<sup>1</sup> DFS does realize, however, that the Commission made a decision to cap the total possible benefit that Capital One could earn under its NSA. DFS also realizes that it would not be completely unreasonable for the Commission to insist that a Functionally Equivalent NSA

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<sup>1</sup> Our NSA includes a provision under which our threshold will be adjusted by the percentage change in our "domestic gross active accounts" as reported in our SEC filings. See Paragraph IIIF.



1 also include a cap. Thus, Discover and the Postal Service negotiated a  
2 competitive cap of \$13 million. This recognizes the fact that DFS should have  
3 the potential to enjoy a benefit proportionate to the one received by Capital One.

4 While DFS is as large a credit card company as Capital One, it is not as  
5 large a mailer. Thus the \$13 million was set to reflect the difference between the  
6 overall sizes of the two companies as First-Class mailers, using total First-Class  
7 Mail volume projections. In very straightforward terms, DFS's projected First-  
8 Class Mail volume is 32% of Capital One's and thus our cap is 32% of theirs. As  
9 a direct competitor, we believe that this is the most equitable result.

10 **Address Quality Issues.** While DFS is a very efficient mailer, we do not  
11 use an internal prospect database. Thus, our return rate is largely predicated  
12 upon the quality of the data in the lists we purchase. When DFS prospects for  
13 new Cardmembers, we are interested in expanding and improving the quality of  
14 our credit card portfolio. Consequently, the drivers that achieve this goal relate to  
15 the type of lists purchased, not to the quality of the postal addresses in the lists.  
16 Moreover, when we buy a list, we do not mail to the entire list, but analyze the list  
17 based on a variety of proprietary factors. As a result, some of the addresses are  
18 purged from the original list and we mail to the remaining addresses. Also, we  
19 process those addresses against the NCOA/CASS database within 60 days  
20 before mailing, which exceeds current Addressing Requirements.

21 Despite these efforts, some of our mail is returned. For Operations Mail  
22 (which is mailed from our Cardmember and Merchant databases and not from a  
23 list), the return rate is low, approximately one-quarter of one percent (0.25%).

1 For Marketing Mail, which is mailed from purchased lists, the weighted average  
2 return rate is 9.3%. We anticipate that our return rate for future mailings will  
3 remain consistent with this figure.

4 As in our baseline NSA, DFS has agreed to receive return data  
5 electronically, which will save the Postal Service a considerable amount of  
6 money, and to use the information to benefit the quality of its mailing lists. Since  
7 we do not have an internal prospect database, we have agreed to work with the  
8 Postal Service and our list processor to analyze the return data we receive from  
9 the Postal Service and use it in an efficient manner to improve our mail quality.  
10 We have also agreed, should we ever develop and use an internal prospect  
11 database, that we would regularly update that database within 30 days of our  
12 receipt of return data.

### 13 **Conclusion**

14 DFS, a direct competitor of Capital One, has negotiated a Functionally  
15 Equivalent NSA with the Postal Service. DFS prides itself on managing its  
16 business closely and with a sophisticated budgeting process. We have provided  
17 the Commission with straightforward volume projections, based on our budget,  
18 that represent minimums and are as accurate as possible. We trust that the  
19 Commission will approve our NSA as soon as reasonably possible pursuant to its  
20 rules for Functionally Equivalent NSAs.

21 On behalf of DFS, I would like to thank the Commission for the time and  
22 effort that it is devoting to this matter.

## Appendix I.

The graph on page seven of this testimony is based upon the following data:

<b>Month</b>	<b>Operations Mail</b>	<b>Marketing Mail</b>	<b>Total Mail</b>
Dec-99	26,019,712	10,983,803	37,003,515
Jan-00	24,656,256	4,442,905	29,099,161
Feb-00	25,283,389	11,560,124	36,843,513
Mar-00	24,889,656	47,080,329	71,969,985
Apr-00	23,954,905	8,880,749	32,835,654
May-00	24,590,695	2,971,024	27,561,719
Jun-00	24,662,650	8,463,686	33,126,336
Jul-00	24,938,017	14,718,654	39,656,671
Aug-00	25,409,691	13,616,328	39,026,019
Sep-00	24,947,667	9,875,462	34,823,129
Oct-00	26,131,086	10,689,321	36,820,407
Nov-00	27,833,898	16,934,257	44,768,155
Dec-00	25,620,543	10,656,050	36,276,593
Jan-01	25,360,153	12,392,639	37,752,792
Feb-01	25,875,912	24,068,360	49,944,272
Mar-01	25,368,388	13,240,232	38,608,620
Apr-01	25,409,041	10,895,366	36,304,407
May-01	25,649,428	5,054,920	30,704,348
Jun-01	25,297,673	14,101,784	39,399,457
Jul-01	25,252,916	10,907,850	36,160,766
Aug-01	25,787,691	21,055,416	46,843,107
Sep-01	25,844,965	18,782,428	44,627,393
Oct-01	26,495,123	38,849,619	65,344,742
Nov-01	27,236,967	29,225,728	56,462,695
Dec-01	27,821,835	11,036,124	38,857,959
Jan-02	27,831,948	20,579,413	48,411,361
Feb-02	27,512,108	18,734,310	46,246,418
Mar-02	28,125,220	9,918,058	38,043,278
Apr-02	27,671,148	9,295,077	36,966,225
May-02	27,316,428	18,309,872	45,626,300
Jun-02	25,995,405	28,061,863	54,057,268
Jul-02	28,180,136	431,865	28,612,001
Aug-02	28,316,130	10,662,159	38,978,289
Sep-02	28,238,399	14,463,979	42,702,378
Oct-02	28,637,176	20,727,322	49,364,498
Nov-02	28,127,623	33,618,431	61,746,054
Dec-02	26,774,983	28,357,215	55,132,198
Jan-03	27,367,651	13,427,613	40,795,264
Feb-03	26,098,149	10,163,281	36,261,430
Mar-03	26,103,841	11,568,258	37,672,099
Apr-03	26,281,431	11,724,500	38,005,931
May-03	26,833,247	9,426,696	36,259,943
Jun-03	25,862,033	7,291,696	33,153,729
Jul-03	25,654,287	8,208,638	33,862,925
Aug-03	25,052,196	8,049,412	33,101,608
Sep-03	24,383,001	8,993,174	33,376,175
Oct-03	24,626,432	8,877,887	33,504,319
Nov-03	23,355,150	20,124,732	43,479,882
Dec-03	24,805,590	11,131,530	35,937,120

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**Postal Rate Commission, Docket Number MC 2004-4**  
**Declaration of Karin Giffney**

2004 SEP -3 P 2: 10

POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

I, Karin Giffney, hereby declare, under penalty of perjury that:

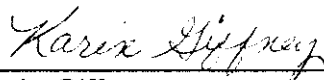
The direct testimony of Karin Giffney on behalf of Discover Financial Services, Inc. (DFS-T-1) in Docket Number MC 2004-4 was prepared by me or under my direction; and

If I were to give this testimony orally before the Commission today, it would be the same.

I, Karin Giffney, further declare, under penalty of perjury that:

The responses to the various Interrogatories and Presiding Officer's Information Requests that have been filed by DFS in this case and which have been designated for inclusion in the record of this docket were prepared by me or under my direction; and

If I were to respond to these interrogatories and Presiding Officer's Information Requests orally before the Commission today, the responses would be the same.



Karin Giffney

Date September 3, 2004

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

Rate and Services Changes To  
Implement Functionally Equivalent  
Negotiated Service Agreement with  
Discover Financial Services, Inc.

Docket No. MC2004-4

DESIGNATION OF WRITTEN CROSS-EXAMINATION

<u>Party</u>	<u>Interrogatories</u>
<b><u>Discover Financial Services, Inc.</u></b>	
<b>Karin Giffney (DFS-T-1)</b>	
American Postal Workers Union, AFL-CIO	OCA/DFS-T1-5, 9
Office of the Consumer Advocate	OCA/DFS-T1-1-10
Postal Rate Commission	POIR No. 1, Questions 1 and 5
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association Inc.	VP/DFS-T1-2-3, 6, 8-10, 13-15
<b><u>United States Postal Service</u></b>	
<b>Ali Ayub (USPS-T-1)</b>	
American Postal Workers Union, AFL-CIO	OCA/USPS-T1-1, 3, 5-6, 9, 12, 20, 22-23, 27-28, 35-39
Office of the Consumer Advocate	OCA/USPS-T1-1-46
Postal Rate Commission	POIR No. 1, Question 2 POIR No. 1, Question 3 POIR No. 1, Question 4 POIR No. 1, Questions 5-8 POIR No. 2

Party

United States Postal Service

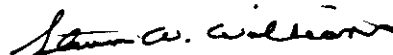
Valpak Direct Marketing Systems,  
Inc. and Valpak Dealers'  
Association Inc.

Interrogatories

Direct Testimony USPS-T1 Witness Ayub

VP/USPS-T1-14

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven W. Williams".

Steven W. Williams  
Secretary

INTERROGATORY RESPONSES OF  
DISCOVER FINANCIAL SERVICES, INC.  
WITNESS KARIN GIFFNEY (T-1)  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
OCA/DFS-T1-1	OCA
OCA/DFS-T1-2	OCA
OCA/DFS-T1-3	OCA
OCA/DFS-T1-4	OCA
OCA/DFS-T1-5	APWU, OCA
OCA/DFS-T1-6	OCA
OCA/DFS-T1-7	OCA
OCA/DFS-T1-8	OCA
OCA/DFS-T1-9	APWU, OCA
OCA/DFS-T1-10	OCA
VP/DFS-T1-2	Valpak
VP/DFS-T1-3	Valpak
VP/DFS-T1-6	Valpak
VP/DFS-T1-8	Valpak
VP/DFS-T1-9	Valpak
VP/DFS-T1-10	Valpak
VP/DFS-T1-13	Valpak
VP/DFS-T1-14	Valpak
VP/DFS-T1-15	Valpak
POIR No. 1, Questions 1 and 5	PRC

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

Rate and Services Changes To Implement  
Functionally Equivalent Negotiated Service  
Agreement with Discover Financial  
Services, Inc.

Docket No. MC2004-4

DESIGNATION OF WRITTEN CROSS-EXAMINATION  
OF DISCOVER FINANCIAL SERVICES, INC.  
WITNESS KARIN GIFFNEY  
(DFS-T-1)

Party

American Postal Workers Union,  
AFL-CIO

Office of the Consumer Advocate

Postal Rate Commission

Valpak Direct Marketing Systems,  
Inc. and Valpak Dealers' Association  
Inc.

Interrogatories

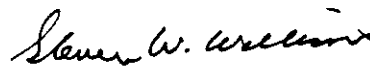
OCA/DFS-T1-5, 9

OCA/DFS-T1-1-10

POIR No. 1, Questions 1 and 5

VP/DFS-T1-2-3, 6, 8-10, 13-15

Respectfully submitted,



Steven W. Williams  
Secretary



INTERROGATORY RESPONSES  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

Designating Parties

**Discover Financial Services, Inc.**

**Karin Giffney (DFS-T-1)**

OCA/DFS-T1-1	OCA
OCA/DFS-T1-2	OCA
OCA/DFS-T1-3	OCA
OCA/DFS-T1-4	OCA
OCA/DFS-T1-5	APWU, OCA
OCA/DFS-T1-6	OCA
OCA/DFS-T1-7	OCA
OCA/DFS-T1-8	OCA
OCA/DFS-T1-9	APWU, OCA
OCA/DFS-T1-10	OCA
VP/DFS-T1-2	Valpak
VP/DFS-T1-3	Valpak
VP/DFS-T1-6	Valpak
VP/DFS-T1-8	Valpak
VP/DFS-T1-9	Valpak
VP/DFS-T1-10	Valpak
VP/DFS-T1-13	Valpak
VP/DFS-T1-14	Valpak
VP/DFS-T1-15	Valpak
POIR No. 1, Questions 1 and 5	PRC

**United States Postal Service**

**Ali Ayub (USPS-T-1)**

OCA/USPS-T1-1	APWU, OCA
OCA/USPS-T1-2	OCA
OCA/USPS-T1-3	APWU, OCA
OCA/USPS-T1-4	OCA
OCA/USPS-T1-5	APWU, OCA
OCA/USPS-T1-6	APWU, OCA
OCA/USPS-T1-7	OCA

Interrogatory

OCA/USPS-T1-8  
 OCA/USPS-T1-9  
 OCA/USPS-T1-10  
 OCA/USPS-T1-11  
 OCA/USPS-T1-12  
 OCA/USPS-T1-13  
 OCA/USPS-T1-14  
 OCA/USPS-T1-15  
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 OCA/USPS-T1-42  
 OCA/USPS-T1-43  
 OCA/USPS-T1-44

Designating Parties

OCA  
 APWU, OCA  
 OCA  
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 APWU, OCA  
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 OCA  
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Interrogatory

OCA/USPS-T1-45

OCA/USPS-T1-46

VP/USPS-T1-14

Direct Testimony USPS-T1 Witness Ayub

POIR No. 1, Question 2

POIR No. 1, Question 3

POIR No. 1, Question 4

POIR No. 1, Questions 5-8

POIR No. 2

Designating Parties

OCA

OCA

Valpak

USPS

PRC

PRC

PRC

PRC

PRC

## Responses of Witness Giffney to OCA/DFS-T1-1

**OCA/DFS-T1-1.** In your testimony at page 2, lines 18-20, you state that you are providing insights into the economic factors, industry trends, and company practices that influence the selection of marketing channels and mail forecasts.

(a) To what degree does the state of the economy (whether we are in a recession, whether better times are ahead, whether consumers are confident, trends in interest rates, etc.) affect the marketing of credit cards? Please address specific, relevant factors.

(b) What are the primary drivers affecting the selection of specific marketing channels?

### **DFS RESPONSE:**

(a) The state of the economy affects the credit card industry in several ways, usually with a lag time of approximately six months. Consumer confidence in an improving economy initially prompts increased spending on credit cards, but not necessarily revolving behavior. As consumers feel secure in their employment and future prospects they are more willing to finance new consumption with unsecured, revolving debt, which improves company profitability. Improved profitability may have a positive effect on funding for marketing programs in general.

Consumer confidence in a worsening economy results in two diverse actions on the part of consumers. Consumers with the means to do so pay off their accounts in full, causing activation rates to decrease and attrition rates to increase across the credit card industry. Others negatively affected by the economy are unable to pay on their accounts and end up defaulting. Both of these actions directly reduce the profitability of the company and may have a negative effect on the funding of marketing programs.

However, there are other factors to consider which may change the dynamics of consumer confidence. Low interest rates during the recent recession made home equity loans very attractive for debt consolidation. Many homeowners without the

## **Responses of Witness Giffney to OCA/DFS-T1-1 (cont)**

means to pay off their credit cards used home equity loans to pay off credit card balances. However, as interest rates rise, home equity loans will become less attractive, and consumers will be willing to borrow more on their credit cards.

Consumer confidence will also impact response rates to marketing programs. If consumers are in the mode of having too much debt or are paying off their debt, response rates become depressed because consumers are not in the market for new credit cards or new debt. Consequently, more marketing dollars are required to obtain a certain level of performance from the business.

*Finally, increasing interest rates also affect the cost of funds upon which credit card loans are made. Should the cost of funds rise too sharply, this may increase the expense line of the business, cutting into profitability, and may result in reduced funding for marketing programs.*

(b) Strategic goals determine the general funding levels of the three main marketing business units: Acquisition, Cardmember Marketing, and Advertising. Advertising does not mail. The program budgets in these other arenas are independent of each other, with program effectiveness driving channel choice. Within Acquisition and Cardmember Marketing, a program's effectiveness is measured by the potential profitability of an account based on the net present value of funds. Potential profitability is determined by several key drivers inclusive of the cost per account, expected response rate, expected activation rate, expected account spend, expected balance carried, and potential write-off rate. These drivers are analyzed by channel to arrive at the best outcome to achieve strategic goals.

## **Responses of Witness Giffney to OCA/DFS-T1-1 (cont)**

For example, in acquiring new accounts, direct mail has a higher cost per account, a higher activation rate, higher carried balances, and average write-off rates. Telemarketing delivers a better cost per account and low write-off rates but, unfortunately, delivers lower activation rates and lower carried balances. The Internet has a low cost per account, with an average activation rate and average carried balances but, unfortunately, delivers a much higher write-off rate. Proprietary analytical tools are used to analyze these drivers and determine the optimal mix of channels to achieve the most profitable new accounts, as well as the number of new accounts, to meet the company's strategic goals.

## **Responses of Witness Giffney to OCA/DFS-T1-2**

**OCA/DFS-T1-2.** In your testimony at page 8, line 14, through page 9 line 7 you provide Before-NSA and After-NSA forecasts of mail volume.

(a) Please provide the models, statistical analyses, estimating procedures, and/or other relevant quantitative documentation substantiating the forecasts.

(b) Please provide your understanding of the underlying factors that would cause Discover to switch between Standard Mail and First-Class Mail, as referenced at page 5, line 19.

### **DFS RESPONSE:**

(a) The quantitative basis for the forecast is the DFS budget. In formulating its budget, DFS does use various models and quantitative procedures. These models are highly sophisticated and proprietary, and consequently, we cannot disclose them.

These models compare various marketing channels, and we use them to determine the most efficient use of our marketing funds. In doing this analysis, we consider recent campaign performance, cost per account, response rates, approval rates, and activation rates. When mail is chosen as the appropriate marketing channel, a total mail volume number is generated.

Moreover, once the budget is set and marketing has determined which channels to utilize to achieve specific business goals, DFS then uses both statistical analyses and modeling to enhance the effectiveness of each channel. These are also highly proprietary.

As for the After-NSA forecast, we arrived at the figure for the increase in volume as a result of the NSA through a straightforward calculation of how many pieces could be upgraded from Standard to First Class by reinvesting postage savings realized through the NSA.

**Responses of Witness Giffney to OCA/DFS-T1-2  
(cont)**

(b) Response rate and cost per piece are the two main factors driving DFS's determination of which direct mail campaigns to send First Class and which to send Standard. We look at performance data for recent mailings to determine the appropriate mix of First Class and Standard. Factors we look at in this process include the expected lift in response rate due to forwarding inherent in First-Class Mail, the quicker in-home delivery of First-Class Mail, and the relative cost difference between First Class and Standard. With the lower First-Class costs that this NSA would generate, DFS would be able to send more mail First Class.

Since the prospect of a discount on First Class, which would narrow the rate difference, is new to us, it is possible that the amount actually upgraded from Standard to First Class will be larger than forecasted. However, the forecast provided is as accurate as possible at this time. Also, as noted in my testimony, there surely will be some "new" First-Class volume, but we cannot predict how much.



## **Responses of Witness Giffney to OCA/DFS-T1-3**

**OCA/DFS-T1-3.** In your testimony at page 5, lines 1-2, you indicate that direct mail is a part of Discover's core strategy. In Appendix 1, you provide Discover's mailing data from December of 1999 onwards for First-Class Mail. Please provide similar data from December 1995 through November of 1999, thereby providing some verification of Discover's mailing trends as related to actual and forecasted volumes over an extended period of macroeconomic variability.

### **DFS RESPONSE:**

**Solicitation Mail.** We do not have marketing mail data prior to December 1999. This applies to both First-Class Mail and Standard Mail.

The reason we do not have any pre-December 1999 marketing mail data is because before 1999 each separate Marketing unit within DFS independently purchased print and mail, generally utilizing third-party brokers. The mailings were sent out on others' permits and few if any postage records were kept by DFS.

During 1999, a centralized Production Services unit was created to purchase print and lettershop services for all Marketing areas. Also, a postal expert was put on staff to deal with the Postal Service and to handle postal matters. Throughout the year postal permits were opened and linked to a centralized CAPS account. By December 1999 (our fiscal year starts on December 1), this process was completed and a structure was in place to accurately record mail volumes and postage expenses. Therefore, DFS's mail records for solicitation mail (First and Standard) start in December 1999.

**Operations Mail.** First-Class Mail volumes are only available for Operations Mail (statement mail) beginning with December 1997. Prior to this, DFS volume was processed through several outside mailing vendors. During

**Responses of Witness Giffney to OCA/DFS-T1-3  
(cont)**

that time, mail volume reporting was inconsistent and incomplete. Beginning in December 1997, DFS was able to fully capture and record all First-Class Operations Mail volume. Below is a table containing First-Class Mail volumes for Operations Mail from December 1997 through November 1999.

**Discover Financial Services, Inc.  
Operations First-Class Mail Volumes  
December 1997 – November 1999**

	<b>FY 1998</b>	<b>FY 1999</b>
<b>Dec</b>	29,620,448	28,170,285
<b>Jan</b>	28,940,610	28,348,055
<b>Feb</b>	28,188,164	28,480,194
<b>Mar</b>	27,637,052	30,163,890
<b>Apr</b>	28,607,506	29,207,320
<b>May</b>	28,071,994	29,415,100
<b>June</b>	28,245,506	29,508,732
<b>July</b>	28,117,687	29,144,140
<b>Aug</b>	27,153,245	29,347,975
<b>Sept</b>	28,539,826	28,649,982
<b>Oct</b>	28,624,119	29,332,321
<b>Nov</b>	<u>27,444,938</u>	<u>30,138,609</u>
<b>Annual Totals</b>	<b>339,191,095</b>	<b>349,906,603</b>

## **Responses of Witness Giffney to OCA/DFS-T1-4**

**OCA/DFS-T1-4.** In your testimony at page 8, lines 18-19, you indicate that your First-Class Mail projections for the next three years are essentially flat, notwithstanding a recent reported industry trend toward lower First-Class Mail volumes. Please explain why the projections are flat, as related to your use of First-Class Mail, Standard Mail, and the drivers that affect marketing programs.

### **DFS RESPONSE:**

Attached is the article I cited in my testimony that noted the industry trend toward lower solicitation mail volumes. This report of lower industry solicitation mail volume is not just limited to First-Class Mailings.

While the overall Before-NSA forecast remains essentially flat, there are separate business factors contributing to the forecasts for Marketing and Operations Mail.

In Marketing, a business goal is to maintain the current level of cardmembers while improving quality. The current level of direct mail marketing is sufficient to maintain our current cardmember level and DFS does not foresee a reason to change it at this time. Another Marketing business goal is to focus on the portfolio side of the business in order to build cardmember balances. Direct mail marketing for this portion is normally sent via Standard Mail. Therefore, although this is a major business goal, it does not impact the volume of First-Class Mail and the Marketing forecast remains constant during years one, two, and three of the NSA.

The main two drivers considered for Marketing programs are response rates and cost per account. Together, the two drivers form the basis for Marketing's business decisions. Given the current cost structure of First-Class

**Responses of Witness Giffney to OCA/DFS-T1-4  
(cont)**

Mail and our budget limitations, we believe the current level of spending for direct mail marketing most economically accomplishes our goals.

The Operations forecast decreases slightly in years two and three of the NSA as a result of two main factors. First, the business goal to maintain the current level of cardmembers directly relates to the volume of statements. Since the number of cardmembers is expected to remain constant, the number of statements should remain fairly stable. Second, there is an increased utilization of electronic statements. This would decrease the number of statements mailed per month. As a result, the Operations Mail volume forecasts decrease slightly.

# Responses of Witness Giffney to OCA/DFS-T1-4 (cont)

DMNews.com | News | Article

Page 1 of 2

## DM NEWS

The Online Newspaper of Record for Direct Marketers

May 10, 2004

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### Survey: Fewer Credit Card Offers Mailed for 2nd Consecutive Years

Annual credit card mail volume for 2003 decreased 12 percent compared with volume in 2002, market researcher Synovate announced this week.

The findings, compiled using Synovate's Mail Monitor, a service of Synovate's financial services practice, showed that 4.29 billion credit card offers were received by U.S. households in 2003, down from 4.89 billion in 2002. Consumer response was 0.6 percent.

The drop follows a record 5.01 billion mailed offers in 2001.

Synovate, Arlington Heights, Ill., said 69 percent of U.S. households received 4.8 offers on average monthly in 2003 versus 7.5 percent of households getting 5.1 offers in 2002.

"During 2003, typical seasonal mailing patterns went out of the window," said Andrew Davidson, vice president of competitive tracking services for Synovate's financial services practice.

Davidson said that 90 percent of credit card direct mail comes from the 10 largest card issuers, and half of those issuers cut back in 2003, causing the overall decline in mail volume. The company also noted that personal bankruptcies reached an all-time high in 2003, and despite recent improvements to the economy, unemployment remains high.

"Card issuers have reacted to this environment by mailing fewer low-introductory-rate offers and decreasing the frequency of mailings to lower-income households," Davidson said.

Meanwhile, he said, "we have seen a significant increase in offers promoting rewards and cash rebates as issuers seek new ways to stand out from the clutter and acquire customers that are less likely to switch."

According to Synovate, U.S. households got 1.27 billion reward offers in 2003, up from 810 million in 2002. Rebate card mail volume increased to 900 million from 680 million over the same period.

"Although volumes were down for the year, I was encouraged by our December 2003 findings," Davidson said. "Many issuers who had cut back overall in 2003 finished with a strong December, and I would not be surprised if the year begins with strong mailing volumes overall."

[http://www.dmnews.com/cgi-bin/artmore.cgi?article\\_id=27020&dest=article](http://www.dmnews.com/cgi-bin/artmore.cgi?article_id=27020&dest=article)

5/10/2004

## Responses of Witness Giffney to OCA/DFS-T1-5

**OCA/DFS-T1-5.** In your testimony at page 9, lines 13-15 you indicate that your projection for the After-NSA forecast is based upon an upgrade from Standard Mail to First-Class Mail for existing marketing campaigns. In order to understand potential Postal Service losses in Standard Mail revenues, and potential gains in First-Class Mail revenues, and the overall level of mailings under previous and projected economic conditions, please provide Discover's monthly data for Standard Mail for the time period December 1995 to December 2003.

### RESPONSE

#### Discover Financial Services, Inc. Standard Mail Volumes December 1999 through November 2003

Month	FY 2000	FY 2001	FY 2002	FY 2003
Dec	46,185,374	62,836,837	26,124,243	37,622,732
Jan	21,201,659	35,036,900	70,399,581	61,877,181
Feb	55,253,673	64,221,153	40,303,066	60,621,690
Mar	42,455,983	46,507,548	27,402,433	48,819,532
Apr	65,933,173	52,261,978	33,946,497	49,460,915
May	54,360,690	46,032,444	30,870,973	44,447,020
June	67,842,744	57,508,640	64,328,566	33,634,169
July	62,997,819	45,641,195	23,206,401	31,166,613
Aug	85,110,470	66,524,211	41,955,362	33,295,819
Sept	71,542,368	51,107,780	45,904,975	33,409,274
Oct	68,523,453	28,632,214	52,597,759	34,490,170
Nov	<u>56,233,554</u>	<u>34,829,111</u>	<u>42,724,616</u>	<u>14,921,093</u>
<b>Annual Total</b>	<b>697,640,960</b>	<b>591,140,011</b>	<b>499,764,472</b>	<b>483,766,208</b>

We have no record of Standard Mail volumes (or of any marketing volumes) for November 1999 and earlier, for the reasons explained in our response to OCA/DFS-T1-3.

**Responses of Witness Giffney to OCA/DFS-T1-6**

**OCA/DFS-T1-6.** Please refer to your testimony at page 13, line 10, through page 14, line 12.

- (a) Please confirm that under the NSA, for Discover's 13 million pieces (Year 1) of new First-Class marketing mail induced from Standard Mail, the receipt of electronic address correction notices for such new marketing mail that is undeliverable-as-addressed will reduce costs to Discover in comparison to Standard marketing mail. If you do not confirm, please explain and describe the types of costs to be incurred.
- (b) Please confirm that under the NSA, for Discover's 156 million pieces (Year 1) of existing First-Class marketing mail, the receipt of electronic address correction notices for such marketing mail that is undeliverable-as-addressed will reduce costs to Discover in comparison to the physical return of such mail. If you do not confirm, please explain and describe the types of costs to be incurred.
- (c) If your response to part (a) of this interrogatory is in the affirmative, please provide an estimate of the total cost savings to Discover or, in the alternative, identify and describe the types of costs to be reduced.
- (d) If your response to part (b) of this interrogatory is in the affirmative, please provide an estimate of the total cost savings to Discover or, in the alternative, identify and describe the types of costs to be reduced.

**RESPONSE.**

- (a) Not Confirmed. It is not clear what costs you are talking about. There are no costs now because there are no returns. If we get an ACS notice and use it, there will be a cost.
- (b) Not Confirmed. Presently we are not doing anything with the physical returns and therefore are incurring no costs. If we get an ACS notice and use it, there will be a cost.
- (c) Not applicable.
- (d) Not applicable.

**Responses of Witness Giffney to OCA/DFS-T1-7**

**OCA/DFS-T1-7.** Please refer to your testimony at page 13, line 10, through page 14, line 12. Assuming approval of the NSA, please explain in detail how Discover will use the electronic address correction notices to increase the quality of addresses used in Discover's future marketing mail campaigns.

**RESPONSE.**

See my response to VP/DFS-T1-6. As noted there, we commonly mail to individuals multiple times on an annual basis, and indeed in some instances individuals are solicited monthly.



**Responses of Witness Giffney to OCA/DFS-T1-8**

OCA/DFS-T1-8. Please refer to your testimony at page 13, line 10, through page 14, line 12, and Attachment F of the Postal Service's Request, Article II. B. 2.

- (a) Please define the phrase "its third party list processor."
- (b) Has Discover informed "its third party list processor" of the contents of Article II.B.2.? Please describe the manner in which Discover informed "its third party list processor," and the nature of any discussions with "its third party list processor."

**RESPONSE.**

(a)-(b) By the "third party list processor" we mean the list processor we use for our marketing mailings. See my response to VP/DFS-T1-6.

### **Responses of Witness Giffney to OCA/DFS-T1-9**

OCA/DFS-T1-9. Please refer to your testimony at page 14, lines 6-9, which refers to "our list processor."

- (a) Please provide the number of list processor(s) currently used by Discover.
- (b) Does Discover currently use one or more list processors with respect to its First Class marketing mail?
- (c) Does Discover currently use one or more list processors with respect to its Standard marketing mail?
- (d) Please describe the types of services offered by the list processors referred to in part (b) of this interrogatory with respect to its First Class marketing mail. Do the list processors referred to in part (b) of this interrogatory provide mailing and production services? Please explain.
- (e) Please describe the types of services offered by the list processors referred to in part (c) of this interrogatory with respect to its Standard marketing mail. Do the list processors referred to in part (c) of this interrogatory provide mailing and production services? Please explain.
- (f) Of the types of services offered by list processors referred to in part (d) of this interrogatory, please identify the types of services utilized by Discover with respect to its First Class marketing mail.
- (g) Of the types of services offered by list processors referred to in part (e) of this interrogatory, please identify the types of services utilized by Discover with respect to its Standard marketing mail.
- (h) Does Discover have any arrangements with its current list processor(s) for the list processor(s) to (i) receive, and/or (ii) use any information obtained from undeliverable-as-addressed First Class marketing mail where such mail is physically returned, or as a result of the receipt of electronic correction notices for "returned" or forwarded mail? Please explain.

### **RESPONSE.**

(a)-(h) DFS uses one list processor for its marketing mail, to do all of its list processing for both First Class and Standard Mail. This includes a variety of services such as address hygiene, address updates, eliminating duplicates, CASS certification, NCOA processing, and other similar processes. We use whatever services we need, which is

**Responses of Witness Giffney to OCA/DFS-T1-9 (cont.)**

from time to time, just about all the services our list processor offers. Our list processor performs no print and mailing functions. We utilize a number of printers and lettershops to perform our print and mailing functions. They receive the lists from our list processor. As more fully described in my response to Valpak VP/DFS-T1-6, our list processor will be receiving our returns from the postal service, analyzing the data, and using the data with us to improve the efficiency of both DFS and the postal system. Currently, we are not using any information from our physically returned First-Class marketing mail.

**Responses of Witness Giffney to OCA/DFS-T1-10**

OCA/DFS-T1-10. Please refer to your testimony at page 14, lines 6-9.

- (a) Under the NSA, with respect to electronic address correction notices provided for Discover's returned First-Class marketing mail, please confirm that Discover or its list processor will "suppress" (i.e., eliminate prospect names and/or addresses from a marketing mail campaign prior to mailing) addresses from mailing lists used in Discover's future marketing mail campaigns. If you do not confirm, please explain.
- (b) Under the NSA, with respect to electronic address correction notices provided for Discover's forwarded First-Class marketing mail, please confirm that Discover or its list processor will correct (i.e., include new name and/or address information) addresses in mailing lists used in Discover's future marketing mail campaigns. If you do not confirm, please explain.

**RESPONSE.**

- (a)-(b) See my response to VP/OCA-T1-6.

## **Responses of Witness Giffney to VP/DFS-T1-2**

### **VP/DFS-T1-2.**

a. During 2003, did DFS request any kind of optional physical return or return information for any of its Standard Marketing mail that were Undeliverable as Addressed ("UAA") and non-forwardable? Please explain any answer that is not an unqualified negative, and indicate which endorsement(s) were used, and the percentage of Marketing mailings on which DFS used each such optional endorsement(s), for its Standard Mail solicitations. Also, please indicate the amount of any extra fees that DFS paid as a result of using such endorsements.

b. During 2003, did DFS request forwarding service for any of its Standard Mail solicitations that might be UAA? Please explain any answer that is not an unqualified negative, and indicate which endorsement(s) were used, and the percentage of Marketing mailings on which DFS used each such optional endorsement(s), for its Standard Mail solicitations. Also, please indicate the amount of extra fees that DFS paid the Postal Service as a result of requesting forwarding service for any of its Standard Mail solicitations.

### **RESPONSE.**

a. No.

b. No.

### **Responses of Witness Giffney to VP/DFS-T1-3**

**VP/DFS-T1-3.** Please refer to your testimony at page 5, lines 16-21, where you state that "some of our Marketing mail is currently sent First Class ...", and page 14, lines 1-2, where you state that "For Marketing Mail ... the weighted average return rate is 9.3%."

a. For the First-Class Marketing mail pieces that were returned during 2003 to DFS marked UAA, please describe briefly all ways in which DFS utilized those returned pieces of Marketing mail. Specifically, to what extent did DFS use the returned pieces to correct (*i.e.*, delete or otherwise change) the list(s) that contained the UAA. addresses? Did DFS open and re-use the contents in the envelopes? Please describe briefly any other ways that DFS used the returned mail pieces.

b. During 2003, for how long a period, on average, did DFS retain returned Marketing mail before disposing of it?

#### **RESPONSE.**

Objections filed. Notwithstanding these objections and without waiving these objections, DFS will answer the question to the extent possible without disclosing proprietary information.

Prior to 2003, DFS used First-Class return information on an experimental basis, from time to time, for various internal purposes. Since the return information was manually inputted, the expense of using any such information was very great. This NSA would give DFS that information in electronic form. This opens the door to more productive and efficient use of such information by DFS. DFS is looking forward to learning how it can best use that information to avoid the cost of mailing undeliverable pieces of marketing mail, and thereby use it to improve both its own productivity and that of the entire postal system.

## Responses of Witness Giffney to VP/DFS-T1-6

### VP/DFS-T1-6.

a. When DFS procures by whatever means (e.g., purchase, rental, lease, etc.) a list of non-customers from a third-party source (e.g., independent list broker or list owner) for Marketing Mail purposes, do the terms of the list procurement generally specify, or limit, the number of times that DFS may use the list? Please explain.

b. After DFS has finished using a list of non-customers obtained from an independent third-party (i.e., when it plans no further use of the list on its own behalf), please explain briefly what DFS does with the list. For example, does DFS simply delete the list from its computers, or does it do something else with it, such as return it?

c. Under what circumstances, if ever, does DFS update, and save or return Marketing mail lists obtained from third-party sources?

### RESPONSE.

Objections filed. Notwithstanding these objections and without waiving these objections, DFS will answer the question to the extent possible without disclosing proprietary information.

Almost all lists have a limitation on the number of times they can be used, and the terms of each contract generally indicate what should happen to a list after it has been used. DFS follows those contractual obligations.

When DFS buys a list, it generally does not mail to the entire list, but does analysis on the lists, selects names from the list, and ultimately mails to a selected portion of the names. Further, DFS “de-dups” (removes duplicate names) among all its lists each month so that it generally does not mail multiple pieces of the same solicitation to any particular individual.

DFS also “repurchases” a number of lists on a monthly basis. Lists that provide positive results are very likely to be repurchased for future use.

After analyzing the lists in order to select which names may be most beneficial to mail to, the lists are forwarded to our list processing vendor for further analysis. The list

### **Responses of Witness Giffney to VP/DFS-T6 (cont.)**

processor provides information relating to the quality of the address so that DFS can make decisions regarding which names should ultimately be included on the final mailing list. During this process, all the return and forwarding information that DFS has been receiving from the Postal Service through the ACS process will be used, and it will be a vital part of that analysis.

Thus, return or forwarding information on any given individual will be part of the analyzing process that DFS performs on the lists it purchases. DFS has been working with its list processor to review all options for utilizing the return information to improve the quality of our mailing lists. The data received through the ACS process will guide the decision making process. Without the specifics of the data, DFS does not know exactly how it will use the data. Thus, while the process that DSFS will use is not fully determined at this time, I am confident that the process will greatly benefit both DFS and the postal system as a whole by increasing efficiency.

Finally, although it should be obvious from the above, on an annual basis, DFS commonly mails multiple times to a given individual.



## Responses of Witness Giffney to VP/DFS-T1-8

**VP/DFS-T1-8.** Please refer to the Postal Service request, Attachment F, Section II.B (p. 2), that states, *inter alia*, “[i]n exchange for a waiver of ACS fees, DFS agrees ... [f]or any address database it maintains for solicitation mail other than First-Class Mail customer correspondence related to account holders (“customer mail”), ... [to] update that database within 30 business days and use the information in future marketing campaigns.”

- a. Please give your interpretation of the term “database” as that term is used in the above-cited sentence. In particular, please explain the extent (if any) to which this sentence applies to a list of non-customers that DFS may in the future rent for a First-Class solicitation mailing. Further, if this sentence applies in any way to lists of non-customers that DFS may in the future rent for Standard Mail solicitation mailings, please explain fully how DFS will use electronic returns to update such lists prior to use.
- b. Please explain what the above-cited sentence means with respect to the electronic address corrections for UAA mail that DFS will receive under terms of the NSA. Will DFS use returns of Marketing mail from other lists in an effort to update new lists which it has procured but to which it has not yet mailed?
- c. Does the above-cited sentence, or any other provision in the NSA, obligate DFS to use the electronic address corrections for UAA mail which it will receive to update every list of non-customers that DFS uses for a First-Class solicitation mailing?
- d. Unless your answer to the preceding part c is an unqualified affirmative, please explain what use(s), if any, DFS will have for electronic address corrections for UAA mail that apply to lists of non-customers.
- e. To the extent that DFS has little or no use for address corrections (electronic or otherwise) to update Marketing mail lists of non-customers, please explain fully what value such address corrections have or will have for DFS.

### RESPONSE.

- a. Unlike Capital One, and many other credit card companies, DFS does not maintain an internal prospect database for solicitations. Should that ever change and DFS establish an internal prospect database, DFS will update that database per the terms of this section. Until such time as DFS establishes and maintains such an internal prospect database, the section cited above (II B 1) will be inoperable.
- b. Not applicable. See my immediate response in a. above and also DFS’s response to VP/DFS-T1-6.
- c. Yes. See Section II B 2 of the DFS NSA. See DFS’s response to VP/DFS-T1-6.
- d.-e. Not applicable.

## **Responses of Witness Giffney to VP/DFS-T1-9**

### **VP/DFS-T1-9.**

- a. Please refer to your testimony at page 14, lines 4-9, and discuss in more detail (i) the type of analysis that you envision doing on the return data that DFS will receive from the Postal Service under the proposed NSA; (ii) how you plan to use the return data to improve the quality of Marketing mail sent by DFS; and (iii) what plans you have, if any, to use the return data to improve the quality of lists procured from third-party providers.
- b. Does DFS have any mechanism, or plans for any mechanism, by which it will transmit corrected lists (or the corrections) back to list brokers, to list owners, or to whomever was the source of a list? If so, please give a general description of what the mechanism is, and how that mechanism will work. If DFS has no plans to provide a list source with any feedback, please so state.
- c. If the electronic address corrections for UAA mail generated under the proposed NSA are never incorporated into a subsequent mailing by DFS, of what value are the electronic address corrections to DFS?
- d. Would you presume that electronic address corrections not subsequently utilized by DFS have value to the Postal Service? Please explain fully any affirmative answer.

### **RESPONSE.**

Objections filed. See DFS's answer to VP/DFS-T1-6. While I am not a lawyer and can not give a legal opinion, my understanding is that passing corrected list information back to others is forbidden by the terms of the contract for privacy reasons.

## **Responses of Witness Giffney to VP/DFS-T1-10**

**VP/DFS-T1-10.** For your response to this question, please assume the following hypothetical. First, the Postal Service eliminates free return of all bulk First-Class Mail that is UAA and cannot be forwarded; *i.e.*, no free physical return, and no free electronic return (bulk First-Class Mail is defined here as any mail that receives a discount below the rate for single-piece mail). Concurrently, the Postal Service (i) increases the discounts for all bulk First-Class Mail by an amount which reflects the savings achieved from eliminating free returns of UAA bulk mail; and (ii) offers as optional services for additional cost-based fees either the physical return of any First-Class UAA mail that cannot be forwarded, or, in lieu thereof, electronic address correction.

a. Under the above-described hypothetical situation, would DFS be willing to pay 60 cents per piece to have its First-Class UAA Marketing mail physically returned?

b. Unless your answer to part a is an unqualified affirmative, would DFS be willing to pay 30 cents per piece to have its First-Class UAA Marketing mail physically returned?

c. Unless your responded affirmatively to either preceding part a or b, please indicate the maximum fee per piece that DFS would be willing to pay for physical returns of its First-Class UAA Marketing mail. If you cannot provide a single amount, please provide a range, such as 15 to 20 cents.

d. Under the above-described hypothetical situation, would DFS be willing to pay 30 cents per piece to receive electronic address corrections for its First-Class UAA Marketing mail?

e. Unless your answer to part d is an unqualified affirmative, would DFS be willing to pay 15 cents per piece to receive electronic address corrections for its First-Class UAA Marketing mail?

f. Unless your responded affirmatively to either preceding part d or e, please indicate the maximum fee that DFS would be willing to pay for electronic address corrections for its First-Class UAA Marketing mail. If you cannot provide a single amount, please provide a range, such as 5 to 10 cents.

### **RESPONSE.**

DFS has performed no analysis on these issues. Thus, I have not basis upon which to answer this question.

## Responses of Witness Giffney to VP/DFS-T1-13

**VP/DFS-T1-13.** Please refer to your testimony at page 13, line 21, through page 14, line 3. There you state that the return rate for your Operations mail "is low, approximately one-quarter of one percent (0.25%)," whereas the weighted average return rate for Marketing Mail is 9.3 percent, and you anticipate that "our return rate for future mailings will remain consistent with this figure."

a. Would you agree that the return rate for your Marketing Mail is approximately 37.2 times the return rate for your Operations mail (*i.e.*,  $9.3/0.25$ )? Please explain fully any disagreement.

b. Would you agree that, from either an operational or a statistical viewpoint, the return rate for your Marketing Mail would appear to differ significantly from the rate experienced with your Operations mail? Please explain fully any disagreement.

### RESPONSE

a. Your math appears to be correct.

b. DFS pays an enormous amount of attention to keeping our customer information current, and spends a great deal of money doing so. I would hope that, as a result of this attention and expense, our information would be as close as possible to 100 percent accurate, and thus the return rate as close as possible to zero.

## **Responses of Witness Giffney to VP/DFS-T1-14**

**VP/DFS-T1-14.** Please refer to your testimony at page 14, lines 4-6. There you state that "DFS has agreed to receive return data electronically, which will save the Postal Service a considerable amount of money...." As a hypothetical, would you agree that if DFS would agree to forego both receipt of returned mailpieces and electronically returned data, then the Postal Service could save considerably more money? Please explain fully any disagreement.

### **RESPONSE**

Your question appears to require an analysis of Postal Service costs under an alternative operational practice, which I cannot provide. Therefore, I have no basis for agreeing or disagreeing

## Responses of Witness Giffney to VP/DFS-T1-15

### VP/DFS-T1-15.

a. Please refer to the Before- and After-NSA volume forecasts shown on pages 8 and 9 of your testimony. Please confirm that if the volumes of First-Class Marketing mail materialize exactly as you project on page 9 of your testimony, the increase in such mail over the Before-NSA Forecast shown on page 8 will be as follows for Years 1, 2 and 3:

Year 1: 13 million pieces

Year 2: 18 million pieces

Year 3: 18 million pieces

If you do not confirm, please provide what you believe to be the correct volumes.

b. Please confirm that if the return rate for Marketing mail is 9.3 percent, as you project on page 14, lines 1-2, the incremental volume of Marketing mail discussed in preceding part a will result in the following incremental volume of returns:

Year 1: 1.209 million pieces

Year 2: 1.674 million pieces

Year 3: 1.674 million pieces

If you do not confirm, please provide what you believe to be the correct volumes.

c. USPS-T-1, Appendix A, page 1, shows the Postal Service's unit cost of electronic returns for each respective year as \$0.34, \$0.36 and \$0.37. Please ignore the fact that the Postal Service's electronic ACS has only an 85 percent success rate, and confirm that at these cost levels the Postal Service's total incremental cost of providing electronic returns to **all** of the returns in preceding part b will be:

Year 1: \$411,060

Year 2: \$602,640

Year 3: \$619,380

If you do not confirm, please provide what you believe to be the correct incremental cost for the Postal Service.

d. In your opinion, will the value that DFS receives from the returns shown in part b above, exceed the costs to the Postal Service shown in part c above? Please explain fully the basis for any affirmative answer.

### RESPONSE

a. Not Confirmed. We have provided minimum projections. We fully anticipate that we will mail more First-Class Mail than this, but cannot accurately estimate it at this time.

b. Not Confirmed. It would depend on how much additional First-Class mail we would mail.

c. I cannot provide testimony concerning the details of Postal Service costs.

d. I have no basis for answering this question.

## Responses of Witness Giffney to POIR 1, number 1

**1 Please refer to DFS-T-1 at page 14, lines 1-3.**

- a) Has Discover used Address Correction Service for First-Class Mail solicitations?  
If so, please provide the following information:
  - i. Identify any time period over which the service was used;
  - ii. Identify the date the service was last used; and
  - iii. If the service is no longer used, describe the reasons for discontinuing use of the service.
- b) Please identify the source of the data upon which witness Giffney based her return rate estimates (e.g., written records, written compilations of data, personal recollections, etc.). If based on written records or compilations of data, please provide this information (or a detailed summary of this information).
- c) Please identify any changes in the nature of Discover's recent First-Class Mail solicitations that may have affected return rates as compared to the mail upon which witness Giffney based her estimates. Also, please explain any adjustments incorporated into witness Giffney's estimates to account for such changes.

### **DFS Response:**

**1a.** No.

**1b.** The data was based on a compilation of data from 1999 to 2002 on multiple solicitation mailings that DFS tracked for returns. Out of a total of 128,750,000 outgoing pieces, 11,990,000 were returned. That yields a return rate of 9.31%:

The 1999 and 2000 mailings were Standard mail, for which DFS used ACS. The 2001, and 2002 were First Class Mailings. DFS used all the data we had, since we have no reason to doubt that the lists we use for First-Class Mailings and Standard Mailings are of the same quality, for UAA purposes.

**1c.** DFS cannot identify any changes in process or practices that would affect its current return rate as compared to that in its testimony.

## Responses of Witness Giffney to POIR 1, number 5

5. **Refer to Rule 196(a)(2) and Request, Attachment E, page 14. Is the negotiated “competitive cap” viewed as a satisfactorily equivalent substitute for the stop-loss provision in the Capital One NSA recommended by the Commission and approved by the Governors? If not, please explain and revise the attachment as necessary.**

### Response

DFS believes that its “competitive cap” is a satisfactory equivalent substitute for the stop-loss provision in the Capital One NSA recommended by the Commission and approved by the Governors.

First, DFS believes that the federal government, having negotiated a rate and service agreement with a specific company, Capital One, has a duty to provide competitors of Capital One with a proportionate business opportunity, should they desire. That duty is fulfilled with the negotiation and approval of a functionally equivalent NSA that is proportionately equal in size to that of Capital One. If DFS is not offered a proportionately equal bargain, the government has not met its obligation.

The DFS NSA is proportionately equal in size to that of Capital One because it has a proportionate cap. Capital One’s first-year volume projections for its NSA were \$1.4 billion. DFS’s first-year volume projections are 451 million. That is a ratio of .32. The cap in Capital One’s NSA was \$40.6 million. By negotiating an NSA with a cap of \$13 million (.32 of \$40.6 million), DFS believes that the Postal Service has fulfilled its duty to provide DFS with a proportionate business opportunity.

Second, in the Capital One case the Commission said that, because there was no “plausible estimate” of the volume of First-Class Mail that Capital One would send during the term of the NSA if no discounts were made available, a significant risk exists that discounts to Capital One could exceed costs avoided by the Postal Service. For this reason the PRC created a “stop-loss.” cap. That is not the case here. DFS has provided not just plausible evidence, but its actual budget number and its actual current



**Responses of Witness Giffney to POIR 1, number 5 (cont.)**

projections. Moreover, unlike Capital One, Discover has a stable, even declining volume history that supports the credibility of that budget number. There is no reasonable risk that the Postal Service could lose money on this NSA, and thus no reason for a stop-loss provision.

**United States Postal Service**

**Ali Ayub  
(USPS-T-1)**

**USPS-T-1**

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001**

**RATE AND SERVICES CHANGES TO IMPLEMENT  
FUNCTIONALLY EQUIVALENT NEGOTIATED  
SERVICE AGREEMENT WITH DISCOVER  
FINANCIAL SERVICES, INC.**

**Docket No. MC2004-4**

**DIRECT TESTIMONY  
OF  
ALI AYUB  
ON BEHALF OF  
UNITED STATES POSTAL SERVICE**

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## **AUTOBIOGRAPHICAL SKETCH**

My name is Ali Ayub. I joined the Postal Service in 2001 and am currently an Economist in the Pricing Strategy group. I provided financial analysis support for the Capital One Negotiated Service Agreement (NSA) filing, Docket No. MC2002-2, and was responsible for implementation of the Governors' Decision in that docket. I also developed performance metrics and reporting tools for the Capital One NSA.

I was part of the negotiating team that developed the Discover NSA and am responsible for all financial analysis presented in the Postal Service filing. In addition, I provided negotiation and financial analysis support for the Bank One NSA. This is my first appearance before the Commission.

I earned a Bachelor's Degree in Finance and Information Systems and a Master's of Business Administration (MBA) from the George Washington University with honors. While pursuing my MBA, I was also a Chairman's Fellow at the Export-Import Bank (EXIM) of the United States. I am currently a candidate for the Level II portion of the Chartered Financial Analyst (CFA) Examination.

1     **I.       PURPOSE AND SCOPE OF TESTIMONY**

          The purpose of my testimony is to describe and analyze the policy and business  
3   considerations that support the Postal Service's negotiated service agreement (NSA)  
4   with Discover Financial Services, Inc. (Discover or DFS). The Discover NSA is  
5   submitted as functionally equivalent to the Docket No. MC2002-2 baseline NSA with  
6   Capital One. Thus, in accordance with 39 C.F.R. § 3001.196, my testimony will include  
7   a detailed explanation of how the Discover NSA is functionally equivalent to the  
8   baseline agreement, and will describe the differences between the Discover NSA and  
9   the baseline agreement. My testimony will also analyze the financial impact of the NSA  
10   on the Postal Service over the three year duration of the agreement, the fairness and  
11   equity of the NSA in regard to other users of the mail, and the fairness and equity of the  
  NSA in regard to the competitors of the parties to the NSA. Finally, I will explain why  
13   functionally equivalent NSAs are important to the business goals of the Postal Service.

14       My testimony will show that (1) the Discover NSA primarily rests on the same  
15   substantive functional elements as the Capital One NSA and provides comparable  
16   benefits; (2) Discover is similarly situated to Capital One, and therefore this NSA has a  
17   comparable competitive impact; and (3) the Discover NSA conforms to the relevant  
18   pricing and classification criteria of the Postal Reorganization Act. My testimony will  
19   explain how the Discover NSA will improve the financial position of the Postal Service.

20       My testimony relies on the concurrently filed testimony of DFS witness Karin  
21   Giffney (DFS-T-1), which is similar to the references provided by Capital One in Docket  
22   No. MC2002-2. I have reviewed Ms. Giffney's testimony on behalf of the Postal

1 Service, and affirm that such testimony may be relied upon in presentation of the Postal Service's direct case.

3 Appendix A to my testimony presents the model that calculates the financial  
4 impacts of the NSA. This model reproduces the calculations provided in Attachments  
5 (1), (2), and (B) of Witness Crum's testimony (USPS-T-3) in Docket No. MC2002-2.  
6 Appendix B explains the similarities and differences of both models. It is important to  
7 note that the underlying principles for calculating Postal Service contribution in the new  
8 format remain the same. Appendix C contains the proposed Data Collection Plan,  
9 which is based on the Data Collection Plan for Docket No. MC2002-2, the baseline  
10 docket.

11 **II. THE IMPORTANCE OF NSAs AND FUNCTIONALLY EQUIVALENT**  
12 **AGREEMENTS**

14 **A. Background and Strategic Advantages of NSAs**

15 In Docket No. MC2002-2, the Commission found that, when the concepts  
16 underlying negotiated pricing and declining block rates are applied fairly, benefits can  
17 accrue, not only to the customer and to the Postal Service, but also to all other postal  
18 customers. As witness Bizzotto pointed out, the Postal Service considers negotiated  
19 pricing a natural extension of its long-standing practice of seeking innovations in pricing.  
20 (MC2002-2, USPS-T-1 at 2-5) Used appropriately, negotiated pricing facilitates  
21 incentives for additional mail volume that benefit the Postal Service, its business  
22 partner, and all users of the Postal Service, through the additional contribution to  
23 institutional costs provided by additional volumes. Given the economic pressures

described below, NSAs represent one tool that can help to mitigate the risk that continued erosion of existing First-Class Mail volume will lead to higher-than-necessary rate and fee increases in the future.

In its opinion in Docket No. MC2002-2, the Commission also concluded that the “Postal Service should ensure that ‘[t]he negotiated rate-and-service package is made available on the same terms to other potential users willing to meet the same conditions of service.” PRC Op., Docket No. MC2002-2, ¶ 7004, p. 136. To address this concern in the Capital One case, the Postal Service, Capital One, OCA, and many intervenors entered into a stipulation and agreement that identified the terms and conditions that must be included for an agreement to be considered comparable to Capital One. The Postal Service codified these elements in DMM G911. The Discover NSA meets these *criteria and affirms the Postal Service’s commitment to extend the Capital One NSA’s terms and conditions to other mailers.*

**B. The Importance Of Functionally Equivalent NSAs to the Postal Service**

Functionally equivalent NSAs are important to the Postal Service because they extend the benefits of favorable baseline agreements to similar relationships with other customers. The Commission's procedural framework for functionally equivalent cases promises to ensure that this objective can be achieved efficiently in an expedited proceeding, where controversy and duplication of effort can be minimized. These procedural goals, in turn, support the related objectives of minimizing the transaction costs involved in pursuing NSAs, reinforcing the financial incentives embodied in NSAs, and thereby promoting a viable and productive NSA process.



1           Expedited litigation and subsequent implementation of the changes proposed in  
this case would benefit both the Postal Service and DFS under the specific terms of the  
3 Discover NSA. If the proposed changes are recommended and approved, the Postal  
4 Service would realize immediate benefit from the agreement in terms of ACS savings.  
5 If this case, however, were to be litigated as a baseline NSA under the Commission's  
6 rules, the protracted proceedings would only delay the Postal Service's ability to capture  
7 the ACS savings. From the customer's perspective, furthermore, lengthy litigation  
8 would result in higher costs as well as delayed business benefits. For very large  
9 mailers, this cost might be easily absorbed within the expected benefit of the NSA, but  
10 for smaller mailers this cost can become prohibitive, in effect lowering the customer's  
11 valuation of the NSA, perhaps making it economically undesirable. Moreover, lengthy  
proceedings would add risk that the business environment might change in such a way  
13 that neither the Postal Service nor DFS could take advantage of the NSA.

14           Turning to one specific issue in the baseline agreement case, in Docket No. MC  
15 2002-2, considerable attention was focused on the risks associated with declining block  
16 rates. Witness Panzer addressed the technical risks associated with non-linear pricing,  
17 and the OCA focused on the risks inherent in providing volume-based incentives in a  
18 future period. A number of participants suggested various mechanisms for mitigating  
19 these risks, implying that the risk of change might be greater than the risk of doing  
20 nothing. Recent volume trends, however, particularly in First-Class Mail, suggest the  
21 opposite.

22           Competition from electronic alternatives, increasing cost pressure on business  
customers, and a recent period of economic sluggishness have contributed to a

1 flattening of demand for First-Class Mail over the last several years. At the same time,  
household growth continues to lead to expansion of the Postal Service's delivery  
3 network. While recent productivity gains have been remarkable, there continues to be  
4 pressure on the Postal Service to come up with ways to continue to fund its large and  
5 growing universal service obligation. In the absence of new ways for the Postal Service  
6 to generate additional volumes and revenues, USPS customers will likely be asked to  
7 absorb higher price increases in the future. Specifically, Discover has a history of  
8 declining First Class Mail volume, and the NSA is expected to help to reverse this trend.

9 In this environment, the Postal Service considers the ability to negotiate  
10 individual price agreements that are consistent with the Act, and to implement them  
11 through rate and classification changes, to be of critical importance. Procedures linking  
favorable baseline agreements with their functionally equivalent offspring will help  
13 ensure that the benefits of the baseline agreements can be efficiently extended to  
14 similar, but distinct, relationships with other mailers. Promoting functionally equivalent  
15 NSAs will also mitigate the concern that a baseline NSA might have adverse  
16 competitive impacts.

### 17 **III. THE DISCOVER NSA IS FUNCTIONALLY EQUIVALENT TO THE CAPITAL** 18 **ONE NSA** 19

20 The Discover NSA fully meets the guidelines outlined in the Commission's Order  
21 No. 1391 (RM2003-5) for functionally equivalent NSAs. The Discover NSA contains the  
22 same functional elements as the Capital One baseline NSA (*i.e.*, declining block rates  
23 and address correction elements, Order 1391 at 50), and will produce comparable

benefits for the Postal Service. Any differences between the Discover NSA and the Capital One NSA do not detract from Discover's status as functionally equivalent.

**A. The Discover NSA Contains the Same Two Functional Elements as the Capital One NSA**

The Discover NSA rests on the same substantive functional elements as the Capital One NSA. First, as in the Capital One agreement, the Postal Service's agreement with Discover calls for the implementation of discounts in the form of declining block rates, according to the schedule outlined below. The discounts are applied only to incremental volume above the negotiated threshold. In other words, no discount would be applied to the first 405 million pieces; a discount of 2.5 cents would be applied to the next 30 million pieces, etc.:

<u>Volume Block</u>	<u>Incremental Discounts</u>
405,000,001 – 435,000,000	2.5¢
435,000,001 – 465,000,000	3.0¢
465,000,001 – 490,000,000	3.5¢
490,000,001 – 515,000,000	4.0¢
515,000,001 – above	4.5¢

Considering these discounts and the testimony of witness Giffney (DFS-T-1) regarding the volume response of Discover to the proposed discount structure, the Postal Service expects Discover's use of First-Class Mail to increase, resulting in additional net contribution to the Postal Service.

Second, as with the Capital One NSA, the Discover agreement contains an address correction element, which creates further cost savings for the Postal Service.

Discover has agreed that the Postal Service can convert the physical return of its

undeliverable-as-addressed (UAA) marketing mailpieces into electronic address correction information through the computerized ACS system. It is the same ACS system that was described more fully in the testimony of witness Wilson in Docket No. MC2002-2. (USPS-T-4 at 2-7)

**B. The Discover NSA Provides the Postal Service a Comparable Benefit**

In discussing the NSA rules governing functionally equivalent agreements, Order No. 1391 stated that the Commission would go beyond an evaluation of the functional elements and examine whether the agreement provides a comparable benefit to the Postal Service. Order 1391 at 51. As an example, the Commission stated that an agreement that is functionally equivalent to Capital One would need to have ACS cost savings. The ACS cost savings that will result from the Discover NSA are significant since over nine percent of its marketing First-Class Mail volume is currently physically returned. (See DFS-T-1 at 9) Also, as in Capital One, the Discover NSA will generate contribution from new First-Class Mail volume. (Appendix A at 1, 10, 11)

**C. Other Terms and Conditions of the Discover NSA**

The Discover NSA incorporates other terms and conditions found in the Capital One NSA. The agreement waives the seal against postal inspection of mail; requires Discover to prepare mail under applicable standards and to enhance its address management practices; includes a transaction penalty; and contains a provision for Discover to make necessary records and data available to the Postal Service to facilitate and monitor compliance. It also enables the Postal Service to cancel for failure by the mailer to provide accurate data, to present properly prepared and paid

1 mailings, to comply with a material term of the NSA, or to use the NSA. See Request,  
Attachment F.

#### 3 **D. New Terms and Conditions in the Discover NSA**

4 By their nature, individual service relationships with the Postal Service reflect the  
5 inherent differences among mailers. The ability to develop a customer-specific NSA  
6 allows the Postal Service to address these differences directly, and to develop an  
7 agreement that best satisfies the needs of an individual customer and the Postal  
8 Service. By improving overall revenue contribution to the Postal Service, such  
9 agreements in turn benefit all postal customers.

10 The exact declining block rates in the Discover NSA do not match those in the  
11 Capital One NSA, although they are of a similar magnitude. The thresholds,  
incremental blocks, and starting discounts are unique to the Discover NSA. However,  
13 the discount structure remains the same as in the Capital One NSA, and it represents a  
14 negotiated agreement between the customer and the Postal Service.

15 In addition, the Discover NSA incorporates two customer-specific terms and  
16 conditions not found in the Capital One NSA: an annual adjustment mechanism to the  
17 threshold and a negotiated cap. As explained below, neither term alters the functionally  
18 equivalent status of the Discover NSA.

19 The first customer-specific term is the annual threshold adjustment. In general,  
20 NSAs patterned after Capital One are intended to increase First-Class Mail marketing  
21 volumes, among other objectives. However, statement volume growth could have the  
22 unintended consequence of diminishing the incentives for new marketing mail volume.  
23 The annual threshold adjustment protects against this contingency, and also mitigates

1 against greater discount exposure (leakage), by adjusting the thresholds in the years  
following the first year of the agreement (the out-years) by the percentage change in the  
3 number of credit card accounts. For example, under the Discover mechanism, if the  
4 number of accounts were currently at an annual volume level of 10 million pieces, and  
5 were to increase to 12 million pieces, there would be a 20 percent adjustment to the  
6 volume threshold. In other words, the logical correlation between accounts and  
7 statement volume will allow the Postal Service to use the threshold adjustment to  
8 mitigate the risk that exogenous factors will result in threshold levels that do not provide  
9 the appropriate incentive for marketing mail.

10 The second customer-specific term is a negotiated cap. The Discover NSA  
11 stipulates a discount cap of \$13 million over the life of the NSA. This cap is the  
*maximum amount of discounts that the Postal Service will give over the three year*  
13 *agreement.* Assuming the discount is spread evenly over the life of the agreement,  
14 Discover would have to mail over 532 million pieces per year to reach the \$4.33 million  
15 cap per year (*i.e.*, \$13 million divided by 3), which would represent a 18 percent  
16 increase in First-Class Mail from its Year 1 Before Rates (Y1BR) forecast of 451 million  
17 pieces.

18 Discover Witness Giffney describes the DFS rationale for proposing the cap and  
19 how it was developed. (DFS-T-1 at 12-13) The Postal Service evaluated the cap  
20 proposed by Discover, and agreed that it reinforces the goals of the NSA approach by  
21 helping to ensure that functionally equivalent status does not create an unbalanced  
22 competitive relationship between the baseline NSA partner and its competitors who  
23 may seek functionally equivalent NSAs.

1 While the Postal Service accepts the logic of this cap as promoting the goals of  
NSAs, it continues to believe that caps for any purpose will not necessarily benefit  
3 either the customer or the Postal Service. Regarding the Capital One type of "stop-  
4 loss" cap, it is unlikely the Postal Service's exposure from misestimation could exceed  
5 the expected ACS savings from the Discover NSA. Therefore, imposition of a cap, in  
6 the context of the Discover NSA, would do nothing to mitigate this specific form of risk.

7 On the other hand, a "stop-loss" cap could risk the loss of an important  
8 opportunity, in the event that contribution which otherwise would have accrued to the  
9 Postal Service from the creation of additional First-Class Mail volume does not  
10 materialize because of the cap. In this regard, I note that the Commission has affirmed  
11 that NSAs ought to result in a net increase in contribution, such that they benefit all  
users of the Postal Service. Imposition of a stop-loss cap in this instance would work  
13 against this aim by potentially arbitrarily limiting such benefits. Moreover, the term  
14 "stop-loss" is in itself a misnomer, in that it suggests losses could be incurred. In fact,  
15 even at maximum discounts, all NSA volumes would make substantial contribution to  
16 institutional costs. Thus, caps of this type would merely reduce potential opportunities  
17 to gain additional revenues.

#### 18 **IV. Financial Impacts**

##### 19 **A. Value Factors/Elements**

20 As with the Capital One NSA, the Discover NSA has three factors affecting the  
21 value: ACS cost savings, new volume contribution, and discount exposure (leakage).  
22 The ACS cost savings are the savings that accrue to the Postal Service from  
23 eliminating the physical return of First-Class Mail marketing pieces with an electronic

1 return notice. Rather than having its undeliverable-as-addressed (UAA) marketing  
pieces physically returned, DFS has agreed to receive most address correction  
3 information electronically through the computerized ACS system. This is the same ACS  
4 system that was described more fully in the testimony of witness Wilson (USPS-T4) in  
5 Docket No. MC2002-2. (MC2002-2, USPS-T-4 at 3-4) Conversion to ACS would save  
6 the Postal Service the cost of returning UAA mail through the mail stream to the  
7 location where DFS would have processed return mail.

8 The second stream of value for the Postal Service is the volume contribution  
9 from any new volume generated by the NSA. This contribution is calculated using the  
10 following inputs: per piece contribution of First-Class Mail, per piece contribution of  
11 Standard Mail, and percent of marketing mail converted from Standard to First-Class.

As Discover Witness Giffney explains, the price incentives in the NSA are  
13 expected to produce a First-Class Mail volume response of 13 million pieces per year.  
14 (DFS-T-1 at 9) The new contribution must offset any substitution leakage that would  
15 result from the loss of contribution from Standard Mail pieces which might be converted  
16 to incremental First-Class Mail marketing pieces. To be conservative, Discover has  
17 estimated that 100 percent of incremental volume would be converted from Standard  
18 Mail. (DFS-T-1 at 9). Both the Postal Service and DFS believe that the incremental  
19 volumes will exceed the forecast. Id. (See Part C., Conservatism of Assumptions,  
20 below.)

21 The final value determinant is the expected discount exposure. The discount  
22 exposure lowers the value of the NSA and is the result of price incentives applied to any  
23 volume that would have occurred without a price incentive. As described by witness



Eakin, setting a threshold below forecast volume is economically efficient because it reduces the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and reduces the gap between marginal price and marginal cost of the mailer's First-Class Mail. (MC2002-2,USPS-RT-2 at 4-5, Tr. 10/2069-70).

I estimate the value to the Postal Service of the DFS agreement, when considering all three value drivers, over the three years of the NSA, as follows:

ACS Cost savings:	\$8.2 million
Increased contribution (less incremental discounts):	\$2.1 million
Discount exposure:	(\$3.2) million

The agreement therefore would result in net benefit to the Postal Service of \$7.1 million over the life of the NSA. A detailed analysis of the financial impact is provided in Appendix A.

#### **B. Financial Model**

I believe that the analysis provided in the valuation model of the Discover NSA complies with the guidelines established by the Commission in Rule 193(e). The model follows witness Crum's methodology in Docket No. MC2002-2, except in instances where a change allows it to conform more closely to the requirements of Rule 193(e). The features of the model are described below; the model is in Appendix A and any changes relative to the Capital One model are discussed in Appendix B.

In order to comply with Rule 193(e)(2), the Postal Service and Discover have provided more data than in Docket No. MC2002-2 in order to present a more representative estimate of the cost and volume effects of the NSA in Years 2 and 3 of

1 the agreement. (see Appendix B at 2-3) In witness Giffney's testimony, Discover has  
provided mail volume forecasts in Years 2 and 3 of the agreement, which are minimum  
3 forecasts as Ms. Giffney notes. (DFS-T-1 at 8).

4 In addition, as described in Appendix B, the Postal Service applies a 4 percent  
5 annual inflationary cost adjustment factor to estimate unit costs in the each year of the  
6 agreement and to account for cost increases since litigation of the Capital One NSA  
7 agreement. This cost adjustment factor will provide a better estimate of the value of the  
8 NSA in the out-years of the agreement as requested by the Commission.<sup>1</sup> In other  
9 respects, the cost assumptions for the DFS mail pieces are based on Docket No.  
10 MC2002-2.<sup>2</sup>

#### 11 **C. Conservatism of Estimated Value**

12 The After Rates (AR) forecast provided by DFS is, in the opinion of the Postal  
13 Service, a conservative estimate of the potential volume response to the price  
14 incentives.

15 In fact, there are reasons why these forecasts would generally tend toward  
16 conservatism. Non-linear pricing of First-Class Mail is relatively new to the Postal  
17 Service. Consequently, USPS customers have no direct experience in planning  
18 postage expenditures, nor in adjusting budgets when – as may happen if Discover  
19 reaches its initial declining block threshold – the cost of customer acquisition declines.  
20 If customers use traditional modeling techniques out of necessity, forecasted volume

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<sup>1</sup> There remains a possibility of a rate increase during the term of the agreement; such an increase has not been accounted for in the revenue calculations. To the extent that revenues in the out-years have been undercounted, greater credence is lent to the conservatism of any assumption.

<sup>2</sup> Just as in the Capital One case, we did not provide estimates of forwarded mail.

1 effects are likely to understate the result of sudden and substantial price reductions.  
Moreover, banks work in a highly regulated and extensively analyzed industry, where  
3 public pronouncements can have significant consequences. This is also likely to act as  
4 a check against unwarranted optimism in projecting future outcomes.

5 One of the difficulties that arises in forecasting volumes in Years 1, 2, and 3 of  
6 the agreement is that, in complex mailing environments, postage is not the only variable  
7 that determines future mailing strategies. The customer and the Postal Service believe  
8 – and the universally accepted principles of economics confirm – that, keeping all other  
9 business variables constant, lower postage costs will provide an incentive for greater  
10 mail volumes. Yet, most companies do not currently forecast the impact of declining  
11 postage rates. Thus, it is difficult to predict the full impact on mail volumes. Thus, the  
point estimates provided are conservative and the Postal Service anticipates that the  
13 volume response will be higher.

## 14 **V. COMPETITIVE IMPACT ANALYSIS**

15 The impact of the Capital One NSA on the competitors of the contracting parties  
16 was discussed and evaluated extensively in the baseline proceeding. (MC 2002-2,  
17 JCP-T-1 at 11-12 and USPS-RT-2 at 11-14.) In the end, the Commission concluded  
18 that the impact on competition would be minor. In this regard, the Commission found it  
19 significant that no competitors of Capital One opposed the NSA.

20 I estimate that the impact on competition of the Discover NSA – which is  
21 functionally equivalent to the Capital One NSA – should be even less, since DFS and  
22 Capital One are similarly situated, i.e., direct competitors. Incidentally, the pool of  
23 competitors who may be disadvantaged because they do not have an NSA decreases

1 as the number of functionally equivalent agreements increase. For functionally  
equivalent agreements with direct competitors of the baseline agreement, any industry  
3 competitive impacts have been addressed in the baseline filing. More importantly,  
4 approving functionally equivalent NSAs provides competitors of Capital One the same  
5 incentives to grow their mail volumes. This is not to suggest that postage prices are the  
6 sole - or even the primary - dimension along which all competitors in an industry may  
7 compete. Indeed, there may be circumstances when it would be impracticable or  
8 otherwise inappropriate to provide NSAs to all competitors within an industry.

## 9 VI. DISCOUNT CAP

10 A "stop-loss provision" or discount cap of \$40 million over three years was  
11 incorporated in the rate and classification changes implementing the Capital One NSA.  
This was not a condition that was negotiated between the Postal Service and Capital  
13 One, but was added by the Commission (PRC Op., MC2002-2, ¶ 5061).

14 The Commission explained that it instituted the stop-loss provision because of  
15 the variability inherent in the volume history of Capital One. The concern over "discount  
16 leakage" exceeding cost savings thus influenced the decision to limit the total value of  
17 discounts Capital One could earn (PRC Op., MC2002-2, ¶ 8024). In setting the cap,  
18 the Commission found that there would be no impact on new volume contribution  
19 because the thresholds were above the revised forecast. As I explained above,  
20 however, a cap based on either cost savings or exposure (leakage) unnecessarily  
21 hinders the ultimate objective of utilizing NSAs as a tool to increase net contribution.  
22 Basing the "stop-loss provision" solely on cost savings would tend to limit participation  
in the NSA process to only large volume mailers who can offer significant cost savings

1 opportunities. This would place customers who do not impose added costs on the  
Postal Service at a disadvantage.

3 More importantly, the stop-loss provision based on the Capital One condition  
4 passing through 95 percent of the cost savings (Op. at 156) would foreclose the  
5 potential contribution from increased volume. It also would impose a competitive  
6 disadvantage for DFS, because its potential cost savings are not nearly as large as the  
7 potential cost savings for Capital One, which is a larger originator of First-Class Mail  
8 marketing solicitations than DFS. Fears that the customer would have significantly  
9 increased mail volumes should be mitigated in the current environment of declining  
10 First-Class Mail volumes, and business conditions related specifically to credit card  
11 issuers (DFS-T-1 at 6).

The conditions that the Commission cited to support a cap on the discounts do  
13 not apply here. The major concern expressed over the course of the Capital One case  
14 was that mail volume would have grown in the absence of a discount so that the  
15 discounts would exceed the cost savings. By comparison, Discover's volume history is  
16 stable, and even if its marketing mail volume were to match its historic high, the Postal  
17 Service would receive a positive benefit from the NSA. Specifically, Discover's highest  
18 annual marketing mail volume was 209 million pieces in 2001, prior to the most recent  
19 rate increase. If Discover, without price incentives, could reach this same level for all  
20 three years of the agreement, they would receive \$8.7 million in discounts on their  
21 before-rates volumes over the term of the agreement (as opposed to the \$3.2 million  
22 estimate presented above in Financial Impacts, part A). This discount earned by  
23 Discover would correlate to exposure for the Postal Service. But, despite the increase

in exposure, the NSA would be contribution-positive because of ACS savings. Under the situation described above, the Postal Service would have underestimated the savings from ACS and, in absolute terms, the savings at 209 million marketing pieces would have been \$11.0 million (as opposed to the \$8.2 million presented above in Financial Impacts, part A). This means that the NSA would still generate \$2.8 million in additional contribution for the Postal Service.

Accordingly, a cap could actually cause harm because it would limit the upside potential of the NSA. As discussed previously, the Discover forecasts are conservative, and it is quite possible that the incremental volume may be higher than predicted. A cap would obviate this possibility.

## **VII PROPOSED PRICES ARE CONSISTENT WITH THE CRITERIA OF THE ACT**

Title 39, Section 3623 requires that the Commission evaluate proposed changes in the classification schedule in accordance with the policies of the Title and the following factors:

1. the establishment and maintenance of a fair and equitable classification system for all mail;
2. the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
3. the importance of providing classifications with extremely high degrees of reliability and speed of delivery;
4. the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;
5. the desirability of special classifications from the point of view of both the user and of the Postal Service; and
6. such other factors as the Commission may deem appropriate.

Section 3622(b) requires that postal rates and fees reflect the policies of the Postal Reorganization Act, and accord with the following factors:

1. the establishment and maintenance of a fair and equitable schedule;

2. the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to, the collection, mode of transportation, and priority of delivery;
3. the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
4. the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
5. the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
6. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
7. simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
8. the educational, cultural, scientific, and informational value to the recipient of mail matter; and
9. such other factors as the Commission deems appropriate.

The arguments presented by witness Plunkett in the Capital One NSA are also

applicable to the Discover NSA:

...the Postal Service believes that by negotiating directly with individual customers, it may be possible, through negotiated service agreements such as the one submitted here, to more accurately present prices that represent the value that the user places on the service being provided (pricing criterion 2) for mail classifications that are desirable to the mailer and the Postal Service (classification criterion 5). In this case, the Postal Service has directly negotiated with the sender of the mail to arrive at classifications and prices that the Postal Service considers to be fair and equitable (classification criterion 1 and pricing criterion 1). As indicated in the testimony of witness Crum, there can be no doubt that the prices presented in this case will cover the costs of providing the service (price criterion 3). In fact, the address improvement steps that Capital One has agreed to will serve to lower the costs currently borne by other customers (pricing criterion 6). For this reason, the classifications and prices presented in this agreement confer beneficial effects on the general public and other ratepayers (classification criterion 1 and pricing criterion 1). The proposed rates do not have an adverse impact on the rates paid by the general public, or other business mail users (pricing criterion 4). The proposed declining block rate structure is relatively simple and maintains a transparent, identifiable relationship between volume levels

1 and applicable rates and fees (pricing criterion 7). (MC2002-2, USPS-T-2,  
2 page 9, line 36 – page 10, line 15).

4 I believe that these pricing and policy issues were comprehensively addressed in  
5 the Capital One NSA docket, and that the logic of functional equivalence enables  
6 reliance on the findings in that case. In this instance, the close comparability of the  
7 structure and elements of the Discover and Capital One NSAs, the similarity of their  
8 situations as mailers, and their status as competitors, warrant full reliance on the  
9 Commission's findings to justify recommending the proposed changes based on the  
10 Discover NSA. Further, the customer-specific rates offered to Discover more than  
11 cover the costs associated with Discover's mail, thus meeting pricing criterion #1,  
12 concerning fairness and equity, as well as pricing criterion #3, which directly addresses  
13 the requirement of covering all costs.

#### 14 **VIII. SUMMARY AND CONCLUSIONS**

15 My testimony has described and discussed the similarities and differences  
16 between the Discover NSA and the Capital One NSA. The Discover NSA has the same  
17 two substantive functional elements of the Capital One NSA, comparable benefits,  
18 other material terms and conditions that were included in the Capital One NSA, and  
19 some additional provisions. The new provisions in the Discover NSA reflect the  
20 differences between the companies that are inherent in their status as individual  
21 mailers. Discover is similarly situated to Capital One, and the fact that it is a direct  
22 competitor makes expeditious treatment of this filing under the Commission's  
23 specialized procedures especially important.



1           Accordingly, I conclude that the Discover NSA meets the standards for functional  
equivalency. The financial model developed to support the Discover NSA is based on  
3   the model submitted in Docket MC2002-2, with analytical enhancements as  
4   recommended by the Commission in Rule 193(e). The Discover NSA also meets the  
5   terms and conditions that must be included for an agreement to be considered  
6   comparable to Capital One, as codified in DMM G911.

7           Finally, based on the Commission's findings and conclusions in its review of the  
8   baseline NSA, the Discover NSA meets the criteria outlined for classifications in Title  
9   39, Section 3623 of the Postal Reorganization Act as well as the criteria for postal rates  
10   and fees as outlined in Section 3622(b) of the Act.

11           For these reasons, I conclude that the Commission should recommend the  
12   *proposed changes as warranted by the projected benefits of the Discover NSA, and as*  
13   functionally equivalent to the Capital One baseline NSA.

## Discover model

### Negotiated Service Agreement

#### Appendix A, page 1

	Year 1	Year 2	Year 3
<b>Return Forecast</b>			
(1) Statement Mail (Stmt)	0.3%	0.3%	0.3%
(2) Marketing Mail (Mktg)	9.3%	9.3%	9.3%
(3) USPS FCM average return rates	1.23%	1.23%	1.23%
<b>Unit cost assumptions</b>			
(4) Inflation cost adjustment factor	4.0%	4.0%	4.0%
(5) Manual Letter Returns Unit Cost	\$ 0.55	\$ 0.57	\$ 0.60
(6) Electronic Letter Returns Unit Cost	\$ 0.34	\$ 0.36	\$ 0.37
(7) Address Change Service (ACS) Success Rate	85.0%	85.0%	85.0%
(8) Percent of new marketing mail switched from Standard Mail (SM)	100.0%	100.0%	100.0%
(9) Contingency Factor	1.03		
(1) DFS MC 2004-4/ DFS-T-1 at page13			
(2) DFS MC2004-4/DFS-T-1 at page 14			
(3) USPS-LR-1/MC2002-2			
(4) USPS MC 2004-4/USPS-T-1 at page 13			
(5) USPS-LR-1/MC2002-2 * (1 + (5))			
(6) USPS-LR-1/MC2002-2 * (1 + (5))			
(7) USPS witness Wilson, T4/MC2002-2			
(8) DFS MC2004-4/DFS-T-1 at page 9			
(9) USPS-LR-1/MC2002-2			

**Discover Model**  
Negotiated Service Agreement  
Appendix A, page 2

	2001	2002	2003	Year 1	Year 2	Year 3
<b>(1) Volume calculations</b>						
<b>Before Rates</b>						
Statement mail	309,000,000	333,000,000	313,000,000	295,000,000	290,000,000	285,000,000
Marketing mail letter	209,000,000	196,000,000	138,000,000	156,000,000	156,000,000	156,000,000
<b>Total</b>	<b>518,000,000</b>	<b>529,000,000</b>	<b>451,000,000</b>	<b>451,000,000</b>	<b>446,000,000</b>	<b>441,000,000</b>
<b>After Rates</b>						
Statement mail	309,000,000	333,000,000	313,000,000	295,000,000	291,000,000	287,000,000
Marketing mail letter	209,000,000	196,000,000	138,000,000	169,000,000	174,000,000	174,000,000
<b>Total</b>	<b>518,000,000</b>	<b>529,000,000</b>	<b>451,000,000</b>	<b>464,000,000</b>	<b>465,000,000</b>	<b>461,000,000</b>

(1) DFS MC 2004-4/ DFS-T-1 at page 8- 9

**Discover Model**Negotiated Service Agreement  
Appendix A, page 3(1)  
Volume (2)  
Rates (3)  
Revenue**Rate Category**

## Single-Piece Letters

First Ounces, except QBRM	0	0.370	\$ -
Qualified Business Reply Mail	-	0.340	-
Additional Ounces	-	0.230	-
Nonmachinable Pieces	0	0.120	-

## Single-Piece revenue

Revenue Adjustment Factor (a) 1.000

(4) Total Single-Piece Postage Revenue -

## Nonautomated Presorted Letters

First Ounce	11,210,871	0.352	3,946,227
Additional Ounces	136,361	0.225	30,681
Nonmachinable Pieces	1,110	0.055	61
Heavy Piece Deduction	4,288	(0.041)	(176)

Nonautomated Presorted Revenue 3,976,793

Revenue Adjustment Factor (a) 1.000

(5) Total Nonautomated Presorted Letters Revenue 3,976,793

## Automation Presort Letters

Mixed AADC Letters	8,988,117	0.309	2,777,328
AADC Letters	19,098,403	0.301	5,748,619
3-Digit Letters	308,202,933	0.292	89,995,256
5-Digit Letters	101,706,322	0.278	28,274,358
Additional Ounces	2,410,072	0.225	542,266
Heavy Piece Deduction	176,937	(0.041)	(7,254)

Automation Presort Letter Revenue 127,330,573

Revenue Adjustment Factor (a) 1.000

(6) Total Automation Presort Letters Revenue 127,330,573

## Automation Carrier Route Letters

First Ounce	1,293,392	0.275	355,683
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-

Automation Carrier Route Revenue 355,683

Revenue Adjustment Factor (a) 1.000

(7) Automation Carrier Route Letters Revenue 355,683

## (8) Total Company Letters Subclass

\$ 131,663,049

Total pieces 450,500,038

(9) Revenue per piece 0.292

(a) Revenue Adjustment Factor not required because customer specific revenue is presented

(1) CBCIS 2003 Discover Volume Data

(2) Rate Schedule

(3) (1) \* (2)

(4) Single Piece Revenue \* Revenue Adjustment Factor

(5) Nonautomated Presorted Revenue \* Revenue Adjustment Factor

(6) Automation Presort Letter Revenue \* Revenue Adjustment Factor

(7) Automation Carrier Route Revenue \* Revenue Adjustment Factor

(8) (4) + (5) + (6) + (7)

(9) (8) / Total pieces

Discover Model  
Registered Service Agreement  
Attachment A, Page 2

Rate Category	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX										DOCKET NO. R2001-1 PRC FIGURES - DISCOVER MAIL MIX						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2004 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)	FY 2003 Mail Volume (Percent)	TY 2004 Total Unit Cost (Dollars)	FY 2003 Mail Volume (Percent)	FY 2003 Mail Volume (Percent)	Current Returns Adj Unit Cost (Dollars)	Current Returns Adj Unit Cost (Dollars)	After Rates Returns Adj Unit Cost (Dollars)		
FIRST-CLASS MAIL LETTERS																	
Nonautomation Presort Letters		0.163	0.063	0.016	0.244	0.254	3,748,977,000	2,873,332,468	5.6%	0.254	11,155,885	3.6%					
Automation Presort Letters																	
Automation Mixed AADC		0.055	0.045	0.018	0.118	0.123	2,504,846,824	2,820,696,002	6.1%	0.123	7,752,541	2.5%					
Automation AADC		0.046	0.044	0.018	0.107	0.111	2,860,656,176	2,836,850,800	5.7%	0.111	15,843,758	5.0%					
Automation 3-Digit		0.042	0.043	0.018	0.104	0.108	21,832,339,000	22,571,247,868	46.6%	0.108	226,048,967	72.2%					
Automation 5-Digit		0.032	0.041	0.018	0.091	0.095	12,720,447,000	14,811,024,110	32.1%	0.095	51,718,335	18.5%					
Automation Carrier Route		0.021	0.064	0.018	0.103	0.107	1,075,333,000	802,262,828	1.7%	0.107	833,517	0.3%					
WEIGHTED AVERAGE / TOTAL	\$8.115	0.858	0.845	0.018	0.113	0.113	44,582,999,000	46,415,243,888	180.0%	0.111	313,852,403	180.0%	\$ (0.0031)	0.108	\$ (0.0031)	0.106	
										Total Unit Cost Estimate, including Contingency =							
										(17) 0.108							

- (1) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3  
(2) Docket No. R2001-1, PRC LR-4, "FCLE/PRCFAXLS", page 1  
(3) Docket No. R2001-1, PRC LR-7, Page 2  
(4) MC2002-2/USPS-1.3, Attachment A, pg. 2  
(5) (2) \* (3) \* (4)  
(6) (5) \* (1 + inflation cost adjustment factor)  
(7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model.  
(8) (6) \* (7) \* (1 + inflation cost adjustment factor)  
(9) (8) / (Sum (8))  
(10) Line Item (8), Weighted Average weighted by percentages in (12)  
(11) GPCIS 2003 Discover Volume Data  
(12) (11) / (Sum (11))  
(13) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) + (Statement Mail Return Forecast - USPS FCM Avg Return Rate) / After Rates Statement Mail  
(14) (ACS Success Rate \* Electronic Letter Returns Unit Cost \* (1 - ACS Success Rate)) + (Manual Letter Returns Unit Cost) \* After Rates Statement Mail \* (Statement Mail Return Forecast - USPS FCM Avg Return Rate) / (15)  
(15) After Rates Statement Mail - USPS FCM Avg Return Rate \* (Manual Letter Returns Unit Cost - Electronic Letter Returns Unit Cost) \* ACS Success Rate  
(16) (10) - (15)  
(17) Contingency Factor (Assumptions)  
(18) (16) Contingency Factor (Assumptions)

DOCKET NO. R2001-1 PRE FIGURES - NATIONWIDE MAIL MD															
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Relate Category	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2004 Total Unit Cost (Dollars)	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Volume (Percent)	FY 2004 Total Unit Cost (Dollars)	FY 2003 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rate Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rate Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS															
Nonautomation Presort Letters		0.163	0.063	0.018	0.244	0.254	3,748,977,000	2,673,332,468	5.8%	0.254	54,966	0.0%			
Automation Presort Letters		0.055	0.045	0.018	0.118	0.123	2,504,844,824	2,820,698,002	6.1%	0.123	1,235,578	0.8%			
Automation Mixed AADC		0.046	0.044	0.018	0.107	0.111	2,880,658,178	2,836,650,800	5.7%	0.111	1,354,043	2.8%			
Automation AADC		0.042	0.043	0.018	0.104	0.108	21,832,335,000	22,571,241,868	49.8%	0.108	82,157,462	58.6%			
Automation 5-Digit		0.032	0.041	0.018	0.091	0.095	12,720,447,000	14,811,023,178	32.4%	0.095	48,807,087	38.4%			
Automation Center Route		0.021	0.064	0.018	0.103	0.107	1,073,353,000	802,282,828	1.7%	0.107	409,875	0.3%			
WEIGHTED AVERAGE / TOTAL	\$0.115	0.050	0.045	0.018	0.109	0.113	44,592,959,000	46,415,245,868	100.0%	0.103	137,447,535	100.0%	0.0445	0.148	0.0260
Total Unit Cost Estimates, Including Contingency													6.157		8.135

- (1) Docket No. R2001-1, PRC LR-2, Volume 4, TYBR7, page 3.  
 (2) Docket No. R2001-1, PRC LR-4, "TECHPRCFA.XLS".  
 (3) Docket No. R2001-1, PRC LR-7, Page 2.  
 (4) MCR003-20USPS-T-3, Attachment A, pg 2.  
 (5) (2) \* (3) + (4)  
 (6) (5) \* (1) + inflation cost adjustment factor  
 (7) Docket No. R2001-1, PRC, LR-4, FCM base year volumes from FCM letter model.  
 (8) Revenue, Pieces, and Weight (GPM) Report.  
 (9) (8) / (Sum (6))  
 (10) Line Item (8), Weighted Average weighted by percentages in (12)  
 (11) CACS 2003 Discover Volume Data  
 (12) (11) / (Sum (11))  
 (13) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) + (Statement Mail Return Forecast \* USPS FCM Avg. Return Rate) / After Rates Statement Mail  
 (14) (ACS Success Rate \* Electronic Letter Returns Unit Cost + (1 - ACS Success Rate) \* Manual Letter Return Unit Cost) \* After Rates Statement Mail \* (Statement Mail Return Forecast \* USPS FCM Avg. Return Rate) / After Rates Statement Mail  
 (15) (ACS Success Rate \* Electronic Letter Returns Unit Cost + (1 - ACS Success Rate) \* Manual Letter Return Unit Cost) \* After Rates Statement Mail \* (Manual Letter Returns Unit Cost \* ACS Success Rate)  
 (16) (10) + (15)  
 (17) (14) - Contingency Factor (Assumptions)  
 (18) (16) - Contingency Factor (Assumptions)

Agreement Structure

Year 1	Year 2	Year 3
Threshold	Threshold	Threshold
Discount	Discount	Discount
\$ 405,000,000	\$ 405,000,000	\$ 405,000,000
\$ 0.025	\$ 0.025	\$ 0.025
\$ 435,000,000	\$ 435,000,000	\$ 435,000,000
\$ 0.030	\$ 0.030	\$ 0.030
\$ 465,000,000	\$ 465,000,000	\$ 465,000,000
\$ 0.035	\$ 0.035	\$ 0.035
\$ 490,000,000	\$ 490,000,000	\$ 490,000,000
\$ 0.040	\$ 0.040	\$ 0.040
\$ 515,000,000	\$ 515,000,000	\$ 515,000,000
\$ 0.045	\$ 0.045	\$ 0.045

Discount on volume above threshold

(1) Before Rates Forecast	451,000,000	446,000,000	441,000,000
(2) After Rates Forecast	464,000,000	465,000,000	461,000,000
Discount in first tier	\$ 750,000	\$ 750,000	\$ 750,000
Discount in second tier	\$ 870,000	\$ 900,000	\$ 780,000
Discount in third tier	\$ -	\$ -	\$ -
Discount in fourth tier	\$ -	\$ -	\$ -
Discount in fifth tier	\$ -	\$ -	\$ -
(3) Discount Earned	\$ 1,620,000	\$ 1,650,000	\$ 1,530,000

Exposure on volume above threshold

(4) Threshold	405,000,000	405,000,000	405,000,000
(5) Before Rates Forecast	451,000,000	446,000,000	441,000,000
(6) Exposed Pieces	46,000,000	41,000,000	36,000,000
(7) After Rates Forecast	464,000,000	465,000,000	461,000,000
Exposure in first tier	\$ 750,000	\$ 750,000	\$ 750,000
Exposure in second tier	\$ 480,000	\$ 330,000	\$ 180,000
Exposure in third tier	\$ -	\$ -	\$ -
Exposure in fourth tier	\$ -	\$ -	\$ -
Exposure in fifth tier	\$ -	\$ -	\$ -
(8) Total Exposure	\$ 1,230,000	\$ 1,080,000	\$ 930,000

(1) Before Rates Total Volume (Volume calcs)

(2) After Rates Total Volume (Volume calcs)

(3) Sum of discounts earned in first tier to fifth tier

(4) Agreement Structure Beginning Threshold

(5) (1)

(6) Before rates - Threshold: The number of total pieces on which Exposure occurs

(7) (2)

(8) Sum of Exposure in first tier to fifth tier

Discover NSA Model

6/21/2004

## Discover Model

Negotiated Service Agreement  
Appendix A, page 7

Year 1      Year 2      Year 3

### Return Costs

UAA Rate

(1)	Statement mail	0.3%	0.3%	0.3%
(2)	Marketing mail	9.3%	9.3%	9.3%

### Before Rates Forecast

(3)	Statement mail	295,000,000	290,000,000	285,000,000
(4)	Marketing mail	156,000,000	156,000,000	156,000,000

### Return Forecast

(5)	Statement mail	885,000	870,000	855,000
(6)	Marketing mail	14,508,000	14,508,000	14,508,000

### Return Costs

(7)	Statement mail	\$ 487,812	\$ 498,726	\$ 509,732
(8)	Marketing mail	\$ 7,996,810	\$ 8,316,682	\$ 8,649,349
(9)	Total	\$ 8,484,622	\$ 8,815,408	\$ 9,159,081

### After Rates Return Costs

(10)	Statement mail	\$ 487,812	\$ 498,726	\$ 509,732
(11)	Marketing mail	\$ 5,431,795	\$ 5,649,067	\$ 5,875,030
(12)	Total	\$ 5,919,607	\$ 6,147,793	\$ 6,384,762

### (13) Return Cost Savings

\$ 2,565,014    \$ 2,667,615    \$ 2,774,320

- (1) DFS MC 2004-4/DFS-T-1 at page13
- (2) DFS MC 2004-4/DFS-T-1 at page14
- (3) DFS MC 2004-4/ DFS-T-1 at page 8
- (4) DFS MC 2004-4/ DFS-T-1 at page 8
- (5) (1) \* (3)
- (6) (2) \* (4)
- (7) (5) \* Manual Letter Returns Unit Cost (Assumptions)
- (8) (6) \* Manual Letter Returns Unit Cost (Assumptions)
- (9) (7) + (8)
- (10) (5) \* Manual Letter Returns Unit Cost (Assumptions)
- (11) ((6) \* ACS Success Rate \* Electronic Letter Returns Unit Cost) + (1 - ACS Success Rate) \* Manual Letter Returns Unit Cost \* (6))
- (12) (10) + (11)
- (13) (9) - (12)



**Discover Model**  
**Negotiated Service Agreement**  
**Appendix A, page 8**

**(1) Standard Mail Regular Revenue per piece**

Mail Category	Revenue per piece	Volume	Weighted Avg.
Mixed AADC Auto	\$ 0.213	2,717,743	578,336
AADC Auto	\$ 0.205	8,952,769	1,830,841
3-Digit Auto	\$ 0.183	189,784,945	34,749,623
5-Digit Auto	\$ 0.166	203,639,150	33,743,007
Basic Nonauto	\$ 0.253	6,053,906	1,534,060
3/5 Digit Nonauto	\$ 0.231	2,695,980	623,580
Total Volume		413,844,493	73,059,448
Revenue per piece			\$ 0.177

**(2) Standard Mail ECR Revenue per piece**

Mail Category	Revenue per piece	Volume	Weighted Avg.
Basic Nonauto Letters	\$ 0.172	2,045,481	351,414
Basic Auto Letters	\$ 0.147	14,964,339	2,204,247
Saturation Letters	\$ 0.126	24,066	3,032
Total Volume		17,033,886	2,558,693
Revenue per piece			\$ 0.150

**(3) Average Revenue per piece** **\$ 0.175**

- (1) Rate Schedule  
(2) Rate Schedule  
(3)  $(\text{Standard Mail Regular Revenue} + \text{Standard Mail ECR Revenue}) /$   
 $(\text{Standard Mail Regular Total Volume} + \text{Standard Mail ECR Total Volume})$

Standard Regular Unit Cost											
From Docket No. R2001-1											
TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	TYBR 2003	DISCOVER
Total	Mail Proc	Delivery	Other	Total	Unit Cost	Unit Cost	Unit Cost	Unit Cost	Unit Cost	Unit Cost	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(Dollars)	(Dollars)	(Dollars)	(Dollars)	(Dollars)	(Dollars)	(Pieces)	(Pieces)	(Percent)	(Dollars)	(Pieces)	(Percent)
0.130	0.042	0.041	0.041	0.16	0.19	1,322,401.662	1,411,242.831	3.2%	0.19	6,053.906	1.5%
0.121	0.044	0.039	0.041	0.17	0.16	4,476,247.838	2,481,782.907	5.7%	0.18	2,695.980	0.7%
0.050	0.039	0.039	0.039	0.10	0.10	2,354,963.527	2,687,599.740	6.1%	0.10	2,717.743	0.7%
0.043	0.038	0.038	0.038	0.09	0.09	2,875,476.520	2,848,635.910	6.5%	0.09	8,952.769	2.2%
0.040	0.038	0.038	0.038	0.08	0.08	15,800,801.986	17,815,858.776	40.6%	0.09	169,784.945	45.9%
0.031	0.037	0.037	0.037	0.07	0.08	11,222,413.732	16,604,852.264	37.5%	0.08	203,639.150	49.2%
Total Average											
0.05	0.04	0.04	0.04	0.09	0.09	37,852,305.265	43,850,172.430	100.0%	0.09	413,844.483	100.0%
Company average letter cost 2003											
\$ 0.09											
(13)											
LETTERS											
Nonauto Basic	0.130	0.042	0.041	0.041	0.16	1,322,401.662	1,411,242.831	3.2%	0.19	6,053.906	1.5%
Nonauto 3/5-Digit	0.121	0.044	0.039	0.041	0.17	4,476,247.838	2,481,782.907	5.7%	0.18	2,695.980	0.7%
Auto Mixed AutoC	0.050	0.039	0.039	0.039	0.10	2,354,963.527	2,687,599.740	6.1%	0.10	2,717.743	0.7%
Auto AutoC	0.043	0.038	0.038	0.038	0.09	2,875,476.520	2,848,635.910	6.5%	0.09	8,952.769	2.2%
Auto 3-Digit	0.040	0.038	0.038	0.038	0.08	15,800,801.986	17,815,858.776	40.6%	0.09	169,784.945	45.9%
Auto 5-Digit	0.031	0.037	0.037	0.037	0.07	11,222,413.732	16,604,852.264	37.5%	0.08	203,639.150	49.2%
Total Average											
0.096	0.05	0.04	0.04	0.09	0.09	37,852,305.265	43,850,172.430	100.0%	0.09	413,844.483	100.0%
Company average letter cost 2003											
\$ 0.09											
(13)											

- (1) Docket No. R2001-1, LR-J-58, LRSAREG.xls, total unit letter costs
- (2) Docket R2001-1, LR-J-60 Revised 11/15/01
- (3) Docket R2001-1, LR-J-60 Revised 11/15/01
- (4) (1) - average from (2) - average from (3)
- (5) (2) + (3) + (4)
- (6) (5) \* (1 + inflation cost adjustment factor)
- (7) Docket No. R2001, PRC, LR-4, SM Base year volumes from SM letter model.
- (8) Revenue, Pieces, and Weight (RPW) Report
- (9) Each row in (8) divided by total in (8)
- (10) (6)
- (11) CBGIS 2003 Discover Volume Data
- (12) Each row in column (11) divided by total in column (11)
- (13) Weighted average costs calculated by multiplying column (10) by column (12)
- (14) Docket No. R2001-1, LR-J-58, LRSAREG.xls, total TY2003 ECR unit letter costs
- (15) Docket No. R2001-1, LR-J-58, LRSAREG.xls, sum of TY2003 ECR unit letter costs
- (16) Docket No. R2001-1, LR-J-117, Revised 1/22/02, TY2003 unit delivery costs \* Inflation cost adjustment factor (Assumptions)
- (17) CBGIS 2003 Discover Volume Data
- (18) Percent of volume in each row of (17) divided by total in (17)
- (19) Weighted average of the unit costs in (18) weighted by the volume percents in (18)
- (20) ((15) - (19)) / Confingency Factor
- (21) ((18) + (20))
- (22) ((13 \* (1) + (21 \* (17)) / ((1 + (17))

SM cost calcs

Discover NSA Model

Revised 8/2/2004

## Discover Model

### Negotiated Service Agreement

#### Appendix A, page 10

	Year 1	(13) Year 2	(14) Year 3
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#### First Class Letter

(1)	Avg Revenue First-Class Letters	0.292	0.292	0.292
(2)	First-Class Statement Letter cost per Piece Before Rates	0.109	0.114	0.118
(3)	First-Class Statement Letter cost per Piece After Rates	0.109	0.114	0.118
(4)	First-Class Statement Letter avg. Contribution Before Rates	0.183	0.179	0.174
(5)	First-Class Statement Letter avg. Contribution After Rates	0.183	0.179	0.174
(6)	First-Class Marketing Letter cost per Piece Before Rates	0.152	0.158	0.165
(7)	First-Class Marketing Letter cost per Piece After Rates	0.135	0.141	0.146
(8)	First-Class Marketing Letter avg. Contribution Before Rates	0.140	0.134	0.128
(9)	First-Class Marketing Letter avg. Contribution After Rates	0.157	0.152	0.146

#### Standard Mail

(10)	Standard Revenue per Piece	0.175	0.175	0.175
(11)	Standard Cost per Piece	0.087	0.090	0.094
(12)	Standard Letter Contribution per Piece	0.089	0.085	0.081

- (1) Revenue per piece (FCM rev calc)
- (2) CurrentTotal Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (3) After Rates Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (4) (1) - (2)
- (5) (1) - (3)
- (6) CurrentTotal Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (7) After Rates Total Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (8) (1) - (6)
- (9) (1) - (7)
- (10) Average Revenue per Piece (SM rev calcs)
- (11) Average Cost per Piece (SM cost calcs)
- (12) Standard Revenue - Standard Cost
- (13) Year 1 \* Inflation cost adjustment factor Year 2 (Assumptions)
- (14) Year 2 \* Inflation cost adjustment factor Year 3 (Assumptions)

## Discover Model

Negotiated Service Agreement  
Appendix A, page 11

	Year 1	Year 2	Year 3	Total
<b>ACS Savings</b>				
(1) Statement Mail	\$ -	\$ -	\$ -	-
(2) Marketing Mail Letter	\$ 2,641,965	\$ 2,747,643	\$ 2,857,549	8,247,157
<b>Contribution from New Volume</b>				
(3) Statement Mail	\$ -	\$ 178,527	\$ 347,956	526,483
(4) Marketing Mail Letter	\$ 891,000	\$ 1,198,971	\$ 1,097,748	3,187,718
<b>(5) Total Exposure</b>	\$ 1,230,000	\$ 1,080,000	\$ 930,000	3,240,000
<b>(6) Total Incremental Discounts</b>	\$ 390,000	\$ 570,000	\$ 600,000	1,560,000
<b>(7) Total USPS Value</b>	<b>\$ 1,912,964</b>	<b>\$ 2,475,141</b>	<b>\$ 2,773,253</b>	<b>7,161,358</b>

- (1) (Statement Mail Return Costs - Statement Mail After Rates Return Costs (UAA calcs))\*Contingency Factor  
 (2) Marketing Mail Return Costs -Marketing Mail After Rates Return Costs (UAA calcs)  
 (3) (Statement Mail After Rates - Statement Mail Before Rates) \* FCM Statement Letter avg. Contribution After Rates  
 (4) (Marketing Mail After Rates - Marketing Mail Before Rates) \* FCM Marketing Letter avg. Contribution After Rates  
 (5) Total Leakage (Disc&Leak)  
 (6) Discount Earned - Total Leakage (Disc&Leak)  
 (7) (1) + (2) + (3) + (4) - (5) - (6)

## IX. DATA AND APPENDICES

### Appendix B

#### EXPLANATION OF FINANCIAL MODEL

The DFS Model incorporates all of the cost and revenue per piece information into one comprehensive workbook. It serves as a presentation mechanism for the customer-specific revenue and cost calculations. The model was built upon the same revenue and cost assumptions (discount, and exposure (leakage) calculations) as the Capital One NSA. The historical and forecasted volumes are provided by DFS witness Giffney (DFS-T-1). These inputs provide the basis for calculating the value of the NSA.

#### Assumptions

The assumptions contain the return rates for DFS' mail mix as provided by witness Giffney (DFS-T-1). The inflation cost adjustment factor, a weighted average of inflationary factors, represents the inflationary cost growth projected by the Postal Service. Currently, that factor is 4 percent. The Capital One manual and electronic return unit costs for letters serve as proxies in the DFS Model (USPS-LR-1/MC2002-2). The manual and electronic return unit costs for flats are the adjusted subclass averages. Costs for Years 1, 2, and 3 of the agreement are adjusted by the inflationary cost growth of 4 percent. The Address Change Service (ACS) success rate was explained by USPS witness Wilson (MC2002-2, USPS-T-4 at 7, Line 4) and is assumed to be constant throughout the life of the agreement. The DFS model assumes 100 percent of the incremental mail volume growth to come from migrating Standard Mail to

1 First-Class Mail for all marketing letters. The contingency is a multiplicative factor  
applied uniformly to all forecasted postal costs.<sup>1</sup>

#### 4 **Volume Calculations**

5 The Volume Calculations contain DFS' mailing mix, consisting of operational mail  
6 and marketing mail letters. The mailing mix for 2001 – 2003 provides a historical view  
7 of DFS' past mailing profile. To illustrate the volume response to incentives, DFS  
8 witness Giffney (DFS-T-1) has provided the volume forecasts for DFS, both in the  
9 absence of an agreement (TYBR) and in the presence of an agreement (TYAR).

#### 11 **First-Class Mail Revenue Calculations**

12 The Rate Category of the model shows the First-Class Mail profile of DFS. It is  
13 similar to the profile in the Capital One NSA (MC2002-2, USPS-T-3). It provides a  
14 representation of the estimated revenue per piece for DFS marketing and operational  
15 mail pieces.

#### 17 **Operational Unit Cost and Marketing Unit Cost**

18 The cost estimates for Operational Unit Cost were built on the same assumptions  
19 of the First-Class Mail Presort Letters/Flats Unit Cost Estimate of witness Crum

---

<sup>1</sup> The contingency is applied to all forecasted postal costs to protect against unforeseen circumstances. It is applied as the very last step in development of the roll-forward costs. It needs to be incorporated in NSA calculations for two reasons. First, the existing rates from which the NSA rates or discounts are being derived include contingency. In the absence of an NSA, the rates that Discover would be paying would have been set so as to recover the contingency. Furthermore, the NSA financial analyses are projections into the future, and the further into the future the projections are made, the more appropriate the application of the contingency.

1 (MC2002-2, USPS-T-3 Atta2.xls) for the Capital One NSA. Estimates for the DFS NSA  
differ from those of the Capital One NSA in the Test Year (TY) calculations, the DFS  
3 volumes, and the total unit cost (columns 17 and 18). The TYBR 2003 unit cost is  
4 based on Docket No. R2001-1, with the weighted distributions calculated from Base  
5 Year (BY) 2000 FCM base year volumes from the FCM letter model from Docket No.  
6 R2001, PRC, LR-4. The TY 2004 cost estimates were derived by multiplying the TYBR  
7 2003 Total Unit Cost by the inflationary growth rate of 4.0 percent.<sup>2</sup> FY 2003 Mail  
8 Volume for DFS was used because it was the latest full year historical volume available.  
9 The Total Unit Cost Estimates, including Contingency (Attachment A, page 4, sources  
10 17 and 18) are equal, based on the assumption that the before and after rates forecasts  
11 of operational mail remain the same.

The Marketing Unit Cost is built on the same assumptions as the Operational  
13 Unit Cost. The major difference is electronic diversion from ACS and the cost  
14 differential between manual and electronic returns for UAA mail. Operational mail does  
15 not receive the Change Service Requested (CSR) endorsement because it needs to be  
16 physically returned to DFS. Marketing mail receives the endorsement, and information  
17 is returned from UAA mail electronically 85 percent of the time. This explains why the  
18 Total Unit Cost, including Contingency, differs in sources 17 and 18 (Pg. 5); the after-  
19 rates unit cost is 1.6 cents less than the before-rates unit cost.

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<sup>2</sup> Columns are labeled as "TYBR 2003" in these sheets because those figures are drawn from Docket No. R2001-1, in which FY 2003 was the test year. Columns are labeled as "TY 2004" because FY 2004 is the first of the three years in which the instant NSA is assumed to be in effect. Estimates for the last two years of the agreement, Years 2 and 3, are presented in the subsequent sheets. FY 2004 is not the exclusive "test year" in this proceeding in the sense that FY 2003 was the test year in the Capital One proceeding. It is, rather, one of three relevant years for which estimates are presented and evaluated.

1

**Discount and Exposure**

3       The declining block rate structure for the proposed NSA begins at 405,000,000  
4 pieces, with a discount of 2.5 cents per piece. Exposure (to the Postal Service)  
5 measures the discounted revenue associated with declining block rates for mail volume  
6 that DFS would have mailed in the absence of the proposed NSA. For each year, DFS'  
7 BR Forecast falls within the second tier of the discount structure. Total exposure is  
8 therefore calculated by adding the first tier to the second tier. Because the first tier  
9 exposure must be maximized before discount calculations apply, the ending threshold is  
10 reduced by the beginning threshold (435,000,000 – 405,000,000), and that difference is  
11 multiplied by the corresponding discount (2.5 cents). The first tier exposure equals  
\$750,000. The second tier exposure is the remaining volume less the beginning  
13 threshold (451,000,000 – 435,000,001), multiplied by the discount (3.0 cents), equaling  
14 (\$480,000). Thus, the total exposure in this case is \$1,230,000 (\$750,000+\$480,000).

15       Based on the Y1AR Forecast, DFS could achieve discounts in the first year of  
16 the agreement, equaling \$1,620,000, using the same formula as exposure. Discounts  
17 are given on pieces mailed above the threshold. Double counting of the 46,000,000  
18 (Y1BR – Beginning Threshold: 451,000,000 – 405,000,000) mail pieces occurs in the  
19 discount and exposure calculations, because the 46,000,000 pieces are the exposure  
20 calculation. The Y1AR of 464,000,000 is made up of the Y1BR plus the 13,000,000  
21 additional marketing pieces. To account for this double counting, the Postal Service  
22 subtracts the discount from the exposure, to get the “real” discount calculation of  
23 \$390,000 (Attachment A, page 11).



## **UAA Calculations**

In lieu of receiving physical returns, DFS will accept electronic diversion of address changes or corrections, as Capital One does. This results in cost savings to the Postal Service by replacing costly physical returns with the less costly transmission of electronic information. The estimated Capital One physical and electronic return unit costs described in USPS-LR-1/MC2002-2 will be used in the DFS model. The total return costs savings vary from the Capital One model because of the different marketing mail volumes, and return rate forecasts (9.3 percent for marketing mail letters).

To calculate the cost savings, multiply the expected volume of Discover's UAA mail times unit costs savings for each piece processed through the ACS times the percentage of Discover's UAA mail that will be processed. The calculation relies upon the evidence in MC2002-2 for 1) the percentage of Discover's UAA mail that will be processed through the ACS system (85%) and 2) the unit savings for each UAA piece processed through the ACS system. The contingency is not applied until page 11.

## **Standard Mail Revenue Calculations and Standard Mail Cost Calculations**

The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are based on the Standard Mail Regular and ECR Billing Determinants of DFS. The revenue per piece for both Regular and ECR is a weighted average of the revenue per piece and DFS volume. The Standard Regular and ECR unit costs are based on Docket No. R2001-1 for TY 2003 unit costs (Docket No. R2001-1, USPS LR-J-58).

These data are based on the USPS version of the cost models, due to the fact that a

PRC-version is not available for some of the data. Specifically, the total unit costs of Standard letters and Standard ECR letters are needed for this analysis. These data are found in the USPS Weight Study (Docket No. R2001-1 USPS LR-J-58), and there is no PRC version of this document. The format for 2004 unit costs follows the First-Class Mail unit cost estimates on pages 4 and 5. This provides the customer-specific revenue and cost data on DFS' Standard Mail. The standard mail cost is adjusted by the contingency, as was the First-Class Mail cost.

### **Contribution Inputs**

The Contribution Inputs calculate the contribution per piece of DFS' operational mail and marketing mail letters. This per piece calculation provides the Postal Service with before and after rates revenue, cost, and contribution for First-Class Mail and Standard Mail on a customer-specific basis. It also allows for forecasting future contribution per piece in the out-years of the agreement by allowing the inflationary growth to be multiplied by the cost of each subclass. Unit revenue remains constant over the three-year agreement.

### **USPS Value**

The total USPS value looks at the value determinants, less the discount and exposure associated with the declining block rate structure. "Contribution from New Volume" is any volume above the before rates forecast multiplied by the difference between the First-Class Mail and Standard Mail estimated contributions. This is so because Discover indicates that all of its new First-Class Mail volume will be switched from Standard Mail (100% conversion). (DFS-T-1 at 11).

## Appendix C

### DISCOVER FINANCIAL SERVICES NSA PROPOSED DATA COLLECTION PLAN

The Postal Service plans to collect the following data pertaining to the NSA with Discover Financial Services, Inc. (DFS):

1. The volume of First-Class Mail solicitations by rate category in eligible DFS permit accounts;
2. The volume of First-Class Mail customer mail by rate category in eligible DFS permit accounts;
3. The amount of discounts paid to DFS for First-Class Mail by incremental volume block;
4. The volume of First-Class Mail solicitations bearing the ACS endorsement that are physically returned to DFS;
5. The number of electronic address correction notices provided to DFS for forwarded solicitation mailpieces, including the number of notices processed by CFS units and separately for PARS (when fully operational).
6. The number of electronic address correction notices provided to DFS for solicitation mailpieces that would otherwise be physically returned, including the number of notices processed by CFS units and separately for PARS (when fully operational).
7. Monthly estimate of the amount of time spent on compliance activity and a description of the activities performed.
8. For each First-Class Mail solicitation mailing list run against NCOA, DFS will provide NCOA contractor reports that separately identify the number of address records checked and the number of corrections made.
9. For each Change of Address record that is used to forward a piece of DFS solicitation mail through ACS under the Agreement, the Postal Service will provide the date the record was created, its move effective date, whether it was for a family or individual move, and each date that the record was used to forward a mail piece. No other information from the record would be provided.

As part of each data collection plan report, the Postal Service will provide an evaluation of the impact on contribution. It will also provide an assessment of trends of DFS' First-Class Mail volume as compared to overall First-Class Mail volume.

1 Data collected under the plan shall be reported annually following the end of the fiscal  
2 year, with the first report being made available at the end of FY2004. The Postal  
4 Service shall provide the data in a PC-available format.

5

**POSTAL RATE COMMISSION  
DOCKET NO. MC2004-4  
DECLARATION OF ALI AYUB**

I hereby declare, under penalty of perjury, that:

The direct testimony of Ali Ayub on Behalf of the United States Postal Service, USPS-T-1, as amended by errata, was prepared by me or under my direction; and

If I were to give this testimony before the Commission orally today, it would be the same.

  
\_\_\_\_\_  
ALI AYUB

DATE 09/03/04

**POSTAL RATE COMMISSION  
DOCKET NO. MC2004-4  
DECLARATION OF ALI AYUB**

I hereby declare, under penalty of perjury, that:

I prepared the interrogatory responses, and responses to the Presiding Officer's Information Requests, which were filed under my signature and which have been designated for inclusion in the record in this docket, as amended by errata; and

If I were to respond to these interrogatories and Presiding Officer's Information Requests orally today, the responses would be the same.

  
\_\_\_\_\_  
ALI AYUB

DATE 04/03/04

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

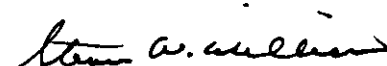
Rate and Services Changes To Implement  
Functionally Equivalent Negotiated Service  
Agreement with Discover Financial  
Services, Inc.

Docket No. MC2004-4

DESIGNATION OF WRITTEN CROSS-EXAMINATION  
OF UNITED STATES POSTAL SERVICE  
WITNESS ALI AYUB  
(USPS-T-1)

<u>Party</u>	<u>Interrogatories</u>
American Postal Workers Union, AFL-CIO	OCA/USPS-T1-1, 3, 5-6, 9, 12, 20, 22-23, 27-28, 35-39
Office of the Consumer Advocate	OCA/USPS-T1-1-46
Postal Rate Commission	POIR No. 1, Question 2 POIR No. 1, Question 3 POIR No. 1, Question 4 POIR No. 1, Questions 5-8 POIR No. 2
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association Inc.	VP/USPS-T1-14

Respectfully submitted,



Steven W. Williams  
Secretary

INTERROGATORY RESPONSES OF  
UNITED STATES POSTAL SERVICE  
WITNESS ALI AYUB (T-1)  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
OCA/USPS-T1-1	APWU, OCA
OCA/USPS-T1-2	OCA
OCA/USPS-T1-3	APWU, OCA
OCA/USPS-T1-4	OCA
OCA/USPS-T1-5	APWU, OCA
OCA/USPS-T1-6	APWU, OCA
OCA/USPS-T1-7	OCA
OCA/USPS-T1-8	OCA
OCA/USPS-T1-9	APWU, OCA
OCA/USPS-T1-10	OCA
OCA/USPS-T1-11	OCA
OCA/USPS-T1-12	APWU, OCA
OCA/USPS-T1-13	OCA
OCA/USPS-T1-14	OCA
OCA/USPS-T1-15	OCA
OCA/USPS-T1-16	OCA
OCA/USPS-T1-17	OCA
OCA/USPS-T1-18	OCA
OCA/USPS-T1-19	OCA
OCA/USPS-T1-20	APWU, OCA
OCA/USPS-T1-21	OCA
OCA/USPS-T1-22	APWU, OCA
OCA/USPS-T1-23	APWU, OCA
OCA/USPS-T1-24	OCA
OCA/USPS-T1-25	OCA
OCA/USPS-T1-26	OCA
OCA/USPS-T1-27	APWU, OCA
OCA/USPS-T1-28	APWU, OCA
OCA/USPS-T1-29	OCA
OCA/USPS-T1-30	OCA
OCA/USPS-T1-31	OCA
OCA/USPS-T1-32	OCA
OCA/USPS-T1-33	OCA



OCA/USPS-T1-34	OCA
OCA/USPS-T1-35	APWU, OCA
OCA/USPS-T1-36	APWU, OCA
OCA/USPS-T1-37	APWU, OCA
OCA/USPS-T1-38	APWU, OCA
OCA/USPS-T1-39	APWU, OCA
OCA/USPS-T1-40	OCA
OCA/USPS-T1-41	OCA
OCA/USPS-T1-42	OCA
OCA/USPS-T1-43	OCA
OCA/USPS-T1-44	OCA
OCA/USPS-T1-45	OCA
OCA/USPS-T1-46	OCA
VP/USPS-T1-14	Valpak
POIR No. 1, Question 2	PRC
POIR No. 1, Question 3	PRC
POIR No. 1, Question 4	PRC
POIR No. 1, Questions 5-8	PRC
POIR No. 2	PRC

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-1. Please refer to 611.1 of Attachment A to the Request containing proposed DMCS language implementing the Discover NSA.

- (a) Please confirm that Discover's eligible First-Class Mail customer correspondence may consist of letter-shaped and flat-shaped pieces. If you do not confirm, please explain.
- (b) Please confirm that Discover's eligible First-Class Mail solicitations may consist of letter-shaped and flat-shaped pieces. If you do not confirm, please explain.

RESPONSE:

(a) Confirmed, although my understanding from our negotiations is that any flat-shaped customer correspondence mail Discover has is de minimis.

(b) Confirmed although my understanding from our negotiations is that all of Discover's solicitation mail is letter shaped.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-2. Please refer to 611.2 of Attachment A to the Request containing proposed DMCS language implementing the Discover NSA.

- (a) Please explain how the 350 million-piece minimum was determined.
- (b) Please explain how the \$250,000 figure was determined.

RESPONSE:

(a) This figure was arrived through negotiations between Discover Financial Service (DFS) and the Postal Service.

(b) This figure was arrived through negotiations between DFS and the Postal Service. DMM G911.2.1.f provides that agreements comparable to the Capital One agreement must have a transactional penalty or minimum payment.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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OCA/USPS-T1-3. Please refer to 611.33 of Attachment A to the Request containing proposed DMCS language implementing the Discover NSA. Please define the term "domestic gross active accounts" as that term is used in 611.33

RESPONSE:

The term "domestic gross active accounts" refers to all DFS customers who reside within the United States of America and have received a statement within the past year.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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OCA/USPS-T1-4. Please refer to Attachment F of the Request, which contains the NSA between the Postal Service and Discover, Article II. A. Please provide citations to the "applicable Federal laws and Postal Service operating instructions" with respect to Postal Service disposal of the physical returns of Discover.

RESPONSE:

DFS' physical returns will be disposed of in the same way as all other disposed mail. Conditions that currently regulate the Postal Service disposal of Standard Mail apply to all classes of mail. The general policies are contained at section 691 et seq. of the Postal Operations Manual. Additional information on disposal methods were addressed in Presiding Officer's Information Request Number 3 in Docket No. MC 2002-2.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-5. Please refer to your testimony at page 9, lines 6-9, where it states "the threshold adjustment [will serve] to mitigate the risk that exogenous factors will result in threshold levels that do not provide the appropriate incentive for marketing mail.

- (a) Please identify and describe the "exogenous factors" referred to in the passage quoted above.
- (b) Please explain why it is important to address or limit the effects of exogenous factors through the threshold adjustment.

RESPONSE:

(a) The term exogenous factors as related to above deals with variables that could increase or decrease the amount of statement or operational mail. Examples of these exogenous factors could be:

- Response rates were to change such that DFS had a larger statement customer base next year;
  - Inactive accounts were to become active and thus begin to receive statements;
- and
- Greater emphasis of cross-sell of products increases the number of customers receiving statements.

The list of exogenous factors that could increase or decrease statement/operation mail is endless but as described in part (b) the Postal Service believes the threshold adjustment mechanism addresses these variables.

(b) The threshold adjustment factor is intended to ensure that any increases or decreases in statement or operational mail alone do not provide the volumes necessary for DFS to obtain the price incentives. If, for example, DFS' customer base were to increase by 2 million users in one year, that in basic terms could mean an increase of

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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24 million statements. While the statement volume alone could not reach the thresholds it could mean the difference between the DFS receiving a 4 cent or 4.5 cent discount.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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OCA/USPS-T1-6. Please refer to your testimony at page 10, lines 4-5, which states "it is unlikely the Postal Service's exposure from misestimation could exceed the expected ACS savings from the Discover NSA."

(a) Please identify and describe all types of "misestimation" referred to in passage quoted above.

(b) On what basis do you make the claim in the passage quoted above? Please provide any documentation supporting the basis for your claim.

RESPONSE:

(a) The term "misestimation" as referred to in my testimony at page 10, lines 4-5 deals with the concept that even if any of the variables used by Discover to develop their volume forecast were to change, the Postal Service has identified the range of outcomes for those possibilities.

(b) The basis for my statement above is that valuing the NSA at different levels of marketing mail volume (the more volatile component of the forecast), and holding all other variables constant, results in the Postal Service having exposure (leakage) only in extreme cases. Please see the table that follows:

% Change in Marketing Volume	USPS Value (millions)
-20%	\$6.1
-10%	\$5.8
10%	\$4.6
20%	\$3.8
30%	\$2.9
50%	\$0.6
75%	(\$2.6)



RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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OCA/USPS-T1-7. Please refer to your testimony at page 6, lines 13-18, and Tables 1, 2 and 3, below showing the incremental volume blocks for Capital One, Bank One, and Discover, respectively.

In Table 1, relating to Capital One, the "% Change" column shows a decline from 4.1% to 3.9% to 3.8 % in the first three incremental volume blocks. The decline repeats itself in the next three volume blocks, although starting at a higher level, 5.5% to 5.2% to 4.9%. A similar pattern is exhibited in Table 2 relating to Bank One. In the case of Discover, however, the decline is monotonic, as shown in the "% Change" column in Table 3. Please explain the rationale for having larger volume blocks associated with lower discounts and vice versa.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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TABLE 1  
Incremental Volume Blocks - Capital One NSA

<u>Volume Range</u>	<u>Change</u>	<u>% Change</u>	<u>Discount</u>
1,225,000,000 1,275,000,000	50,000,000	4.1%	\$0.030
1,275,000,001 1,325,000,000	49,999,999	3.9%	\$0.035
1,325,000,001 1,375,000,000	49,999,999	3.8%	\$0.040
1,375,000,001 1,450,000,000	74,999,999	5.5%	\$0.045
1,450,000,001 1,525,000,000	74,999,999	5.2%	\$0.050
1,525,000,001 1,600,000,000	74,999,999	4.9%	\$0.055
1,600,000,001 above			\$0.060

Source: Docket No. MC2002-2, Request of the United States.  
Postal Service for a Recommended Decision on Experimental  
Changes to Implement Capital One NSA, Attachment B,  
Rate Schedule 610A.

TABLE 2  
Incremental Volume Blocks - Bank One NSA

<u>Volume Range</u>	<u>Change</u>	<u>% Change</u>	<u>Discount</u>
535,000,000 560,000,000	25,000,000	4.7%	\$0.025
560,000,001 585,000,000	24,999,999	4.5%	\$0.030
585,000,001 610,000,000	24,999,999	4.3%	\$0.035
610,000,001 645,000,000	34,999,999	5.7%	\$0.040
645,000,001 680,000,000	34,999,999	5.4%	\$0.045
680,000,001 above			\$0.050

Source: Docket No. MC2004-3, Request of the United States.  
Postal Service for a Recommended Decision on Classifications,  
Rates and Fees to Implement a Functionally Equivalent  
Negotiated Service Agreement with Bank One Corporation,  
Attachment B, Rate Schedule 612A.

TABLE 3  
Incremental Volume Blocks - Discover NSA

<u>Volume Range</u>	<u>Change</u>	<u>% Change</u>	<u>Discount</u>
405,000,000 435,000,000	30,000,000	7.4%	\$0.025
435,000,001 465,000,000	29,999,999	6.9%	\$0.030
465,000,001 490,000,000	24,999,999	5.4%	\$0.035
490,000,001 515,000,000	24,999,999	5.1%	\$0.040
515,000,001 above			\$0.045

Source: Docket No. MC2004-4, Request of the United States.  
Postal Service for a Recommended Decision on Classifications,  
Rates and Fees to Implement a Functionally Equivalent  
Negotiated Service Agreement with Discover Financial  
Services, Attachment B, Rate Schedule 611A.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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RESPONSE:

The incremental volume blocks and the corresponding price incentives were negotiated by DFS and the Postal Service. These different incremental blocks, among the agreements, reflect the fact that each mailer has unique decision and mailing characteristics, and the structure agreed upon by DFS satisfies their needs.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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OCA/USPS-T1-8. Please refer to your testimony at page 8, lines 11-12, and the Commission's opinion in Docket No. MC2002-2, at pages 68-70.

- (a) Please confirm that the Postal Service developed an analysis of the type described by the Commission with respect to Discover's future demand for First-Class solicitation mail. If so, please provide the analysis. If not please explain.
- (b) Please explain how each incremental volume block relates to Discover's future demand for First-Class solicitation mail so as to provide an incentive to increase the incremental volume of solicitation mail.

RESPONSE:

- a) The Postal Service did not fit a demand curve for Discover as illustrated in the Commission's opinion in Docket No. MC2002-2, at pages 68-70. As I noted in my testimony, I relied on the analysis of Postal Service witness Eakin (USPS-RT-2) from MC2002-2
- b) Witness Giffney's testimony (DFS-T-1) describes the overall effect of the agreement on Discover's demand.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-9. Please refer to your testimony at page 8, lines 11-12, and the Commission's opinion in Docket No. MC2002-2, at pages 71-73.

- (a) Please confirm that the Postal Service has developed an analysis of the type described in the Commission's opinion with respect to Discover. If you do confirm, please provide the analysis. If you do not confirm, please explain.
- (b) Please explain how, in the absence of an analysis referred to in part (a) above, the Postal Service has avoided the "design defects" described in the Commission's opinion with respect to the declining block rates applicable to Discover under the NSA.

RESPONSE:

a) Not confirmed. The analysis was not done, in part, because NSA rules do not require this type of analysis. More importantly, the analysis from the Commission's opinion in Docket No. MC2002-2, at pages 71-73, relates to an NSA that is comprised solely of declining block rates, as it does not account for the ACS savings. The Commission's rules, however, appropriately focus the financial analysis on the financial impact of the NSA, which would necessarily require an analysis of the total impact, not just the impact of two components (leakage and new contribution.)

b) The "design defects" described in the Commission's opinion appear to consider declining block rates absent other considerations. As I have explained on pages 10-11 of my testimony, the ACS cost savings provisions should generate a considerable net benefit to the Postal Service. The economic effect of the NSA cannot be meaningfully analyzed without considering this benefit. As the Discover NSA also produces net contribution gains from ACS savings it has a different design, and therefore would not be subject to the same defects. In Appendix A of my testimony, I

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF  
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show that, based on the volume threshold, Discover's volume projections and estimated cost savings, even with "leakage" the net contribution received by the USPS increases.

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TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-10.** Please refer to pages 12 and 13 of your testimony.

- a. Did you perform or obtain different projections of Discover's before- and/or after-rates volumes for the years that the NSA will be in effect? If so, please provide such projections and supporting documentation. If not, why not?
- b. Did you perform or obtain (e.g., from Finance) analyses of the effect of the NSA on postal finances other than the analysis contained in Appendix A of your testimony? If so, please provide such analyses and supporting documentation. If not, why not?

**RESPONSE:**

- a) No, I did not perform or obtain different projections on Discover's before and after rate volumes for the years that the NSA will be in effect. The Postal Service does not have the company-specific data required to make a point projection of future demand. However, the Postal Service is satisfied with the volume projection provided by Discover, and believes that the data provided by the company supports this projection. Please refer to POIR 1, question 4.
- b) No, I did not perform or obtain analyses of the effect of the NSA on postal finances, other than the analysis contained in Appendix A of my testimony. Deviations from witness Crum's financial analysis are explained in Appendix B of my testimony.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-11.** Please refer to page 16 of your testimony.

- a. Please assume that Discover's Year-1 before-rates volume estimate of 451 million pieces is normally distributed. Please confirm that under this assumption, the probability that before-rates volumes in Year 1 would be greater than 451 million is 50 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
- b. Please assume that Discover's Year-1 before-rates volume estimate of 451 million pieces is normally distributed with coefficient of variation of ten percent.
  - i. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 451 million is 50 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
  - ii. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 466 million is approximately 37 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
  - iii. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 481 million is approximately 30 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.
  - iv. Please confirm that under these assumptions, the probability that before-rates volumes in Year 1 would be greater than 496 million is approximately 16 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

**RESPONSE:**

- a) There is no evidence to suggest that Discover's forecast is "normally distributed." However, if you assume that the forecast is normally distributed, then, by definition, there is a 50% chance the before rates volume will exceed 451 million pieces, and a 50% chance that it will be lower.
- b) There is no evidence to suggest that Discover's forecast is "normally distributed." However, if you assume that the forecast is normally



RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

distributed, then the calculations assign probabilities to specific volume levels correctly.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
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**OCA/USPS-T1-12.** Please refer to the attachment to this interrogatory and confirm that under the Commission's MC-2002-2 methodology, the stop-loss volume for Bank One would be 497.6 million pieces. If you do not confirm, please provide the correct volume and show its derivation.

**DISCOVER NSA**  
Stop Loss Estimate**TABLE 1**  
**ACS Related Savings**

[1]	Manual Letter Returns Unit Cost	\$0.55
[2]	Electronic Letter Returns Unit Cost	\$0.34
[3]	Discover Return Rate - Solicitation Mail	9.3%
[4]	Address Change Service (ACS) Success Rate	85%
[5]	Discover TYBR Customer Mail Volume	295,000,000
[6]	Discover TYBR Solicitation Mail Volume	156,000,000
[7]	Solicitation Mail % of TYBR Volume	34.59%
[8]	Discover ACS Unit Cost Savings	\$0.00568739
[9]	Discover TYBR Equilibrium Solicitation Volume	497,630,513
[10]	Total ACS Test Year Savings	<b>\$2,830,220</b>

**TABLE 2**  
**Discount Leakage**

<b><u>Volume Block</u></b>		<b><u>Incremental Volume</u></b>	<b><u>Discount</u></b>	<b><u>Discount Leakage</u></b>
[1]		[2] = [1b] - [1a]	[3]	[4] = [2] * [3]
[a]	[b]			
405,000,000	to 435,000,000	30,000,000	\$0.025	\$750,000
435,000,001	to 465,000,000	29,999,999	\$0.030	\$900,000
465,000,001	to 490,000,000	24,999,999	\$0.035	\$875,000
490,000,001	to <b>497,630,513</b>	7,630,512	\$0.040	\$305,220
515,000,001	to		\$0.045	\$0
				<b>\$2,830,220</b>

**TABLE 1**

## Notes &amp; Sources

- [1] USPS-T-1 (Ayub), Appendix A, page 1
- [2] USPS-T-1 (Ayub), Appendix A, page 1
- [3] USPS-T-1 (Ayub), Appendix A, page 1
- [4] USPS-T-1 (Ayub), Appendix A, page 1
- [5] USPS-T-1 (Ayub), Appendix A, page 2
- [6] USPS-T-1 (Ayub), Appendix A, page 2
- [7]  $= [9] / ([8] + [9])$
- [8]  $= ([1] - [2]) * [3] * [4] * [7]$
- [9] = Table 2 [1b]
- [10]  $= [8] * [9]$

**TABLE 2**

## Notes and Sources:

- [1] Request, Attachment B
- [3] Request, Attachment B

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**RESPONSE:**

Not confirmed. The Postal Service's understanding of the "stop-loss" provision is that the "stop-loss" is equal to 95% of the ACS cost savings over the term of the agreement. The ACS cost savings as presented in Appendix A, page 11, line (2), of my testimony is \$8,006,949. Assuming this ACS cost savings calculation, the cap on the total discount that Discover could earn over the term of the agreement would be: \$7,606,602 ( $85\% \cdot \$8,006,949$ ). If Discover were to mail 605,702,267 pieces in Year 1 of the agreement they would reach the maximum discount for the term of the agreement, and would be ineligible for any additional discounts over the remaining two years of the agreement.

Threshold		Discount	Volume	Discount Earned
405,000,000	435,000,000	\$0.025	30,000,000	\$750,000
435,000,000	465,000,000	\$0.030	30,000,000	\$900,000
465,000,000	490,000,000	\$0.035	25,000,000	\$875,000
490,000,000	515,000,000	\$0.040	25,000,000	\$1,000,000
515,000,000		\$0.045	90,702,267	\$4,081,602

However, the more likely scenario would be that Discover would mail lower volume levels each of the three years. This would result in higher volume levels needed to reach the "stop-loss," because, at the start of each year, the discount starts at \$0.025, and the above example

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includes an extreme example of 90,702,267 pieces at the \$0.045 price  
incentive tier counting towards the discount earned.

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**OCA/USPS-T1-13.** Please assume that Discover's Year-1 before-rates volume estimate of 451 million pieces is normally distributed. Under this assumption, please confirm that the coefficient of variation of that estimate must be no greater than 6.1 percent in order for the probability of the Postal Service's not losing money to be greater than 95 percent. If you do not confirm, please provide an estimate of the maximum coefficient of variation and explain its derivation.

**RESPONSE:**

Not confirmed. With the given parameters assumed by your question, the probability is 0.95 that volume would not exceed 497.6 million pieces. These calculations are based on the premise that there is no increase in volume because of the price incentives. I do not agree that the assumptions provided are plausible as they assume that (1) exogenous factors would cause Before Rates volume to exceed the estimated level of 571 million pieces by a wide margin, yet would have no effect on After Rates volume; (2) the declining block rate discounts offered in the NSA would have no effect on the volume of First Class mail entered by Discover; and (3) the ratio of statements to marketing pieces remains constant at all volume levels. In the instance of the first-case, the higher volumes would also result in higher cost savings. Thus, the assumptions are unsupported by any data I have seen.

I am unable to provide alternative estimates. While it would be possible to solve for a standard deviation, such that expected discounts would equal expected ACS savings, even a minimal volume response would ensure positive contribution to the Postal Service.

Finally under no circumstance does the Postal Service lose money. Under extreme circumstances, it is possible that the opportunity cost of implementing

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the NSA is higher than if it were not pursued, but under no circumstance are any of the pieces contribution negative.



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**OCA/USPS-T1-14.** Please provide an estimate, and explain its derivation, of the coefficient of variation of Bank One's

- a. Year 1 volume estimate of 451 million pieces;
- b. Year 2 volume estimate of 446 million pieces;
- c. Year 3 volume estimate of 441 million pieces.

**RESPONSE:**

The volume estimates for Years 1, 2, and 3 were provided by Discover. The forecast provided by Discover is a qualitative forecast based on internal research and consensus of internal Discover stakeholders. The Postal Service cannot provide an estimate for the coefficient of variation of Discover's forecast volume for the three-years of the agreement because there are no sample data points on which to base this calculation, as the presumed data points and methodology used to develop the observed variance in OCA/USPST1-11, 12 and 13 were not used to produce the forecasts. Providing these coefficients of variation in isolation of an established sample point will not provide any meaningful estimate of these terms.

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**OCA/USPS-T1-15.** Please confirm that *ceteris paribus* the coefficient of variation of a volume projection increases as one projects farther into the future. If you do not confirm, please explain.

**RESPONSE:**

Not confirmed. The purpose of my testimony is not to offer opinions on the principles of forecasting. It is my understanding, however, that depending on the variable that is being forecast, longer range estimates may be more reliable than shorter range estimates. This does not necessarily mean that it is in any way easier to produce a precise point estimate in a period that is farther in the future. Furthermore, assuming "ceteris paribus" it could be argued that the only thing that causes the volume forecast to differ from the actual value, whether in one year or ten years, is because things are not "ceteris paribus" -- that all things are not equal. But the point is mooted because the forecasts used in this case were not produced through sampling or regression analysis, but instead incorporated business judgments from a variety of internal Discover resources. Moreover, the testimony of Discover's witness shows that the estimates of the additional volume of First Class solicitation mail that will be generated by the proposed rate discounts is likely to be greater than the Postal Service has assumed in its financial and cost analysis in this case.

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**OCA/USPS-T1-16.** Please confirm that 85 percent of Discover's mail that shifts from Standard to First-Class will incur *new* electronic return costs. Please confirm that 15 percent of Discover's mail that shifts from Standard to First-Class will incur *new* manual return costs. If you do not confirm, please explain. If you confirm, please indicate where this cost is accounted for in Appendix A of your testimony.

**RESPONSE:**

Not confirmed. Of Discover's marketing mail that shifts from Standard to First-Class, of the *pieces that are returned* 85% of pieces will incur electronic return costs and 15% will incur manual return costs. However, of the volume of mail that shifts, the manual return for 1.96% will already be accounted for in the cost structure of First-Class Mail. These additional costs are accounted for in Appendix A, page 5, column 15 (After Rates Returns Adjustment Cost). In addition, the model does not consider any increases in TYAR marketing volume in its calculation of ACS costs savings.

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**OCA/USPS-T1-17.** Please refer to page 16 of your testimony.

a. Please assume that Discover's Year-1 before-rates volume estimate of 451 Million pieces is normally distributed with coefficient of variation of ten percent.

i. Please confirm that under these assumptions, the probability that before rates volumes in Year 1 would be greater than 436 million is approximately 63 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation. Docket No. MC2004-4 5

ii. Please confirm that under these assumptions, the probability that before rates volumes in Year 1 would be greater than 421 million is approximately 75 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

iii. Please confirm that under these assumptions, the probability that before rates volumes in Year 1 would be greater than 406 million is approximately 84 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

**RESPONSE:**

Not confirmed. The premise of the questions is based on assuming that the Discover forecast is normally distributed, and that we were able to calculate both the standard deviations and the mean of the sample used to produce the forecast to produce the coefficient of variation. I am unable to verify or calculate a standard deviation and a mean, and believe there are minimal benefits to this analysis. However, if I were to guess a coefficient of variation of ten percent I would confirm the above probabilities.

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**OCA/USPS-T1-18.** Please assume that Discover's Year-1 before-rates volume estimate of 451 million pieces is normally distributed. Under this assumption, please confirm that the coefficient of variation of that estimate must be greater than 6672 percent in order for the probability of Discover's Year-1 before-rates volume being less than 406 million to be at least 75 percent. If you do not confirm, please provide an estimate of the minimum coefficient of variation and explain its derivation.

**RESPONSE:**

Please see OCA/USPS-T1-17.

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**OCA/USPS-T1-19.** Please assume that Discover's Year-1 before-rates volume estimate of 451 million pieces is normally distributed. Under this assumption, please confirm that the coefficient of variation of that estimate must be at least 14.8 percent in order for the probability of Discover's Year-1 before-rates volume being less than 406 million to be at least 25 percent. If you do not confirm, please provide an estimate of the minimum coefficient of variation and explain its derivation.

**RESPONSE:**

Please see OCA/USPS-T1-17.

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**OCA/USPS-T1-20.** Please assume that Discover's Year-1 threshold is 405 million pieces and that its before-rates volume estimate of 451 million pieces is normally distributed with coefficient of variation of 10 percent. Under these assumptions, please confirm that the probability of the Postal Service's paying discounts on mail that it would receive in the absence of discounts is 84.6 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

**RESPONSE:**

Not confirmed. The probability of the Postal Service paying discounts on a portion of volume that would be mailed is identified as "Exposure" or "discount leakage" in the Appendix A, as well as in my testimony. As the TYBR forecast provided by Discover is higher than the threshold, one can assume that the Postal Service is aware that there is a strong probability that discounts will be paid on some volume that would have been mailed in the absence of a discount. In my model, I have accounted for these costs.

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**OCA/USPS-T1-21.** Please assume that Discover's Year-1 threshold is 405 million pieces and that its before-rates volume estimate of 451 million pieces is normally distributed with coefficient of variation of 14.8 percent. Under these assumptions, please confirm that the probability of the Postal Service's paying discounts on mail that it would receive in the absence of discounts is 75.5 percent. If you do not confirm, please explain, provide the correct probability, and show its derivation.

**RESPONSE:**

Please see OCA/USPS-T1-20.



**OCA/USPS-T1-22.** Please refer to your testimony at VI. Discount Cap, pages 15-17, and PRC Op. MC2002-2, page 154, footnote 83, which states:

This excludes any potential increased contribution as a result of Capital One responding to the declining block rate structure by increasing its volume of First-Class Mail. The commission is excluding this potential contribution because the record does not provide an adequate basis for evaluating the response of Capital One (and its competitors) to the declining block rates. See Chapter V, Section M, for the analysis leading to this conclusion.

Please expand on your testimony and address the Commission's concern with respect to unknown before rates volumes and the unknown response to discounts.

**RESPONSE:**

Discover's Before Rates First-Class marketing letter volume—the only type of First-Class mail over which Discover appears to have significant discretion over volume—would have to increase by over 75% of current marketing letter volume before the resulting “leakage” from the NSA rate discounts outweighed the ACS cost savings generated by the discounts.

Increases of this magnitude are extremely unlikely. Discover's historical volumes, in contrast to those of Capital One, have been quite stable in recent years. Moreover, the terms of the NSA establishing an annual threshold adjustment and merger adjustments provide structural safeguards against the risk that Discover could obtain volume-related discounts for increases in First-Class mail volume caused by a merger or an organic increase in the scale of Discover's business.

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**OCA/USPS-T1-23.** Please refer to your testimony at VI. Discount Cap, pages 15-17, and PRC Op. MC2002-2, page 154, para. [8025], which states:

Third party mailers will be unharmed by the NSA so long as the dollar amount of the volume discounts the Postal Service makes available to Capital One is not greater than the costs it avoids as a result of the return mail feature of the agreement.

Please explain how the Postal Service has protected third party mailers from harm should the dollar amount of the volume discounts provided to Discover exceed the costs avoided as a result of the return mail feature of the Discover NSA.

**RESPONSE:**

The NSA cannot result in a contribution loss for the Postal Service because the combination of ACS cost savings and the effects of incremental and retained First Class Mail volume, together, exceed any potential exposure (discount on existing volume). However, the risk of not pursuing an NSA is not zero. Ignoring the cost savings on existing volume, the Postal Service loses 13 million pieces in Year 1, and 18 million pieces in Years 2 and 3 of the agreement. The potential exposure to the Postal Service is, at a minimum, identified below.

	<u><b>YEAR 1</b></u>	<u><b>YEAR 2</b></u>	<u><b>YEAR 3</b></u>
Volume	13,000,000	18,000,000	18,000,000
Contribution*	\$0.158	\$0.152	\$0.147
Opportunity Cost	\$2,050,564	\$2,742,385	\$2,641,653

\*MC2004-4 USPST-1-Appendix A page 10 line 9

The chart above illustrates that no NSA, at a minimum, means an opportunity cost of at least \$7.3 million in additional contribution over the term of the NSA that is "lost."

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**OCA/USPS-T1-24.** Please refer to your testimony at Appendix A, page 10, lines (2), (3), (6) and (7) for Year 1, and the accompanying notes.

- (a) For Year 1, please confirm that the "First-Class Operational Letter cost per Piece Before Rates" should be 0.106. If you do not confirm, please explain and provide all calculations.
- (b) For Year 1, please confirm that the "First-Class Operational Letter cost per Piece After Rates" should be 0.106. If you do not confirm, please explain and provide all calculations.
- (c) For Year 1, please confirm that the "First-Class Marketing Letter cost per Piece Before Rates" should be 0.148. If you do not confirm, please explain and provide all calculations.
- (d) For Year 1, please confirm that the "First-Class Marketing Letter cost per Piece After Rates" should be 0.131. If you do not confirm, please explain and provide all calculations.

**RESPONSE:**

(a) Not confirmed. The base cost of \$0.106 does not include the contingency factor, whereas \$0.109 includes the contingency factor of 1.03 from USPS-LR-1/MC2002-2. \$0.109 equals \$0.106 (Current w>Returns Adjusted Total Unit Cost) multiplied by 1.03 (contingency factor contained on page 1 of Appendix A). The inclusion of the contingency factor does not increase the value of the NSA.

(b) Not confirmed. The base cost of \$0.106 does not include the contingency factor, whereas \$0.109 includes the contingency factor of 1.03 from USPS-LR-1/MC2002-2. \$0.109 equals \$0.106 (After Rates w>Returns Adjusted Total Unit Cost) multiplied by 1.03 (contingency factor contained on page 1 of Appendix A).

(c) Not confirmed. The base cost of \$0.148 does not include the contingency factor, whereas \$0.151 does include the contingency factor of 1.03

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from USPS-LR-1/MC2002-2. \$0.151 equals \$0.148 (Current w>Returns Adjusted Total Unit Cost) multiplied by 1.03 (contingency factor contained on page 1 of Appendix A).

(d) Not confirmed. The base cost of \$0.131 does not include the contingency factor, whereas \$0.135 does include the contingency factor of 1.03 from USPS-LR-1/MC2002-2. \$0.135 equals \$0.131 (Current w>Returns Adjusted Total Unit Cost) multiplied by 1.03 (contingency factor contained on page 1 of Appendix A).

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**OCA/USPS-T1-25.** Please refer to your testimony Appendix A, pages 3, 4 and 5.

- (a) Please confirm that the "WEIGHTED AVERAGE/TOTAL" of 313,052,403 and 137,447,635 in column 11 on pages 4 and 5, respectively, sum to 450,500,038, the "Total Pieces" in column (3) on page 3. If you do not confirm, please explain.
- (b) On page 4, please explain how the "WEIGHTED AVERAGE/TOTAL" of 313,052,403 in column 11 was derived. Show all calculations.
- (c) On page 5, please explain how the "WEIGHTED AVERAGE/TOTAL" of 137,447,635 in column 11 was derived. Show all calculations.
- (d) Please confirm that the volumes for the specified Nonautomation Presort Letters and Automation Presort Letters rate categories in column 11 on pages 4 and 5 sum to the volumes of the same Nonautomation Presort Letters and Automation Presort Letters rate categories on page 3, column 1. If you do not confirm, please explain.
- (e) On page 4, please explain how the volumes of Nonautomation Presort Letters and Automation Presort Letters in column 11 were derived. Show all calculations.
- (f) On page 4, please provide all calculations that show the derivation of the percentages in column 12 associated with Nonautomation Presort Letters and Automation Presort Letters.
- (g) On page 5, please explain how the volumes of Nonautomation Presort Letters and Automation Presort Letters in column 11 were derived. Show all calculations.
- (h) On page 5, please provide all calculations that show the derivation of the percentages in column 12 associated with Nonautomation Presort Letters and Automation Presort Letters.

**RESPONSE:**

- (a) Confirmed.
- (b) The total of 313,052,403 is the total sum of the Discover's statement volume at the different rate categories. These values are the reconciled volume numbers from the USPS Permit system and Discover.

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<u>Rate Category</u>	<u>Volume (column 11)</u>
Nonautomation Presort Letters	11,155,885
Automation Mixed AADC	7,752,541
Automation AADC	15,543,758
Automation 3-Digit	226,048,367
Automation 5-Digit	51,718,335
Automation Carrier Route	833,517
<b>TOTAL</b>	<b>313,052,403</b>

(c) The total 137,447,635 is the total sum of the Discover's marketing volume at the different rate categories. These values are the reconciled volume numbers from the USPS Permit system and Discover.

<u>Rate Category</u>	<u>Volume (column 11)</u>
Nonautomation Presort Letters	54,986
Automation Mixed AADC	1,235,576
Automation AADC	3,554,645
Automation 3-Digit	82,154,566
Automation 5-Digit	49,987,987
Automation Carrier Route	459,875
<b>TOTAL</b>	<b>137,447,635</b>

(d) Confirmed

(e) The volumes of Nonautomation Presort Letter and Automation Presort Letter in column 11 are actual Discover volumes broken into rate categories. The only calculations used were to sum specific rate categories across all permits.

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(f)

<b>Rate Category</b>	<b>Volume</b>	<b>/</b>	<b>Total Volume =</b>	<b>Percentage</b>
Nonautomation Presort Letters	11,155,885		313,052,403	3.56%
Automation Mixed AADC	7,752,541		313,052,403	2.48%
Automation AADC	15,543,758		313,052,403	4.97%
Automation 3-Digit	226,048,367		313,052,403	72.21%
Automation 5-Digit	51,718,335		313,052,403	16.52%
Automation Carrier Route	833,517		313,052,403	0.27%
<b>TOTAL</b>	<b>313,052,403</b>		<b>N/A</b>	<b>100.00%</b>

The percentages are calculated by dividing the "Volume" for each rate category column by the "Total Volume". This is reflected in footnote (12) on page 4 of Appendix A.

(g) Please see answer (e) above.

(h)

<b>Rate Category</b>	<b>Volume</b>	<b>/</b>	<b>Total Volume =</b>	<b>Percentage</b>
Nonautomation Presort Letters	54,986		137,447,635	0.04%
Automation Mixed AADC	1,235,576		137,447,635	0.90%
Automation AADC	3,554,645		137,447,635	2.59%
Automation 3-Digit	82,154,566		137,447,635	59.77%
Automation 5-Digit	49,987,987		137,447,635	36.37%
Automation Carrier Route	459,875		137,447,635	0.33%
<b>TOTAL</b>	<b>137,447,635</b>		<b>N/A</b>	<b>100.00%</b>

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**OCA/USPS-T1-26.** Please refer to your testimony Appendix A, pages 4 and 5.

- (a) On page 4, in columns (14) and (16), please confirm that the "Total Unit Cost Estimates, Including Contingency" of 0.109 and 0.109, respectively, are not used anywhere in Appendix A. If you do not confirm, please explain.
- (b) On page 5, in columns (14) and (16), please confirm that the "Total Unit Cost Estimates, Including Contingency" of 0.151 and 0.135, respectively, are not used anywhere in Appendix A. If you do not confirm, please explain.
- (c) Please explain the rationale for calculating, and intended use of, the figures referred to in parts (a) and (b) of this interrogatory.

**RESPONSE:**

- (a) Not confirmed. The "Total Unit Cost Estimates, Including Contingency" of \$0.109 and \$0.109 are used on page 10 of Appendix A at line(s) 2 and 3.  
  
The cost is used in calculating the First-Class Statement Letter avg. Contribution Before and After Rates.
- (b) Not confirmed. The "Total Unit Cost Estimates, Including Contingency" of \$0.151 and \$0.135 are used on page 10 of Appendix A at line(s) 6 and 7.  
  
The costs are used in calculating the First-Class Marketing Letter avg. Contribution Before and After Rates.
- (c) The contingency factors were applied to the cost estimates following the guidelines used by the Postal Service to account for unanticipated cost increases. The contingency in the NSA as well as the cost inflation adjustment factor are both variables that rise the per piece cost to account for any increase in the base cost. Combined the contingency factor of 3% and the inflation factor of 4% should account for any cost increases.



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**OCA/USPS-T1-27.** Please refer to your testimony at VI. Discount Cap, pages 15-17, and PRC Op. MC2002-2, page 156, para. [8031]. Please confirm that in the case of Capital One, the Commission established an annual stop-loss amount equal to 95 percent of \$14,259 million, based upon an equilibrium annual volume of 1,559,248 thousand. If you do not confirm, please explain.

**RESPONSE:**

In the Capital One case no volume projections were provided for Years 2 and 3 of the agreement. The Commission projected savings of \$14,229 million per year which was the projected savings over the test year and forecasted the exact same savings over the remaining years. The Commission capped the total price incentives at 95% of the projected cost savings over the three years. The volume of 1,559,248, thousand, as presented above, represents the volume Capital One would have had to mail to reach the cap. However this assumes that the ratio of statements and marketing pieces remains constant at higher volumes which may be unrealistic. The higher the proportion of marketing mail the higher the cost savings would be which would in turn increase the cap.

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**OCA/USPS-T1-28.** Please refer to PRC Op. MC2002-2, pages 152-156, and the attachment to this interrogatory.

- (a) Please confirm that in Table 3, the calculated stop-loss estimate for Discover is consistent with the Commission's calculation of the stop-loss estimate with respect to Capital One. If you do not confirm, please explain and provide the correct stop loss estimate. Please show all calculations.
- (b) Please confirm that in Table 3, the stop-loss estimate, if recommended, would limit the total dollar amount of the discounts awarded to Discover to no more than 95 percent of the total dollar amount of savings realized by the Postal Service during the three year period of the Discover NSA. If you do not confirm, please explain.
- (c) Refer to Table 2 in Year 1. Please confirm that the TYBR volume of 497,630,513 would permit Discover to mail 92,630,513 ( $497,630,513 - 405,000,000$ ) additional pieces in Year 1, more than 7.1 ( $92,630,513 / 13,000,000$ ) times Discover's Year 1 estimated volume response of 13 million pieces. If you do not confirm, please explain.
- (d) Refer to Table 2 in Year 2. Please confirm that the TYBR volume of 501,928,341 would permit Discover to mail 96,928,341 ( $501,928,341 - 405,000,000$ ) additional pieces in Year 2, more than 5.3 ( $96,928,341 / 18,000,000$ ) times Discover's Year 2 estimated volume response of 18 million pieces. If you do not confirm, please explain.
- (e) Refer to Table 2 in Year 3. Please confirm that the TYBR volume of 506,540,893 would permit Discover to mail 101,540,893 ( $506,540,893 - 405,000,000$ ) additional pieces in Year 2, more than 5.6 ( $101,540,893 / 18,000,000$ ) times Discover's Year 3 estimated volume response of 18 million pieces. If you do not confirm, please explain.

**DISCOVER NSA  
Stop Loss Estimate Model**

**TABLE 1  
Year 1 - ACS Related Savings**

[1]	Manual Letter Returns Unit Cost	\$0.55	[1]
[2]	Electronic Letter Returns Unit Cost	\$0.34	[2]
[3]	Discover Return Rate - Solicitation Mail	9.3%	[3]
[4]	Address Change Service (ACS) Success Rate	85%	[4]
[5]	Discover TYBR Customer Mail Volume	295,000,000	[5]
[6]	Discover TYBR Solicitation Mail Volume	156,000,000	[6]
[7]	Solicitation Mail % of TYBR Volume	34.59%	[7]
[8]	Discover ACS Unit Cost Savings	\$0.00568739	[8]
[9]	Discover TYBR Equilibrium Volume	497,630,513	[9]
[10]	Total ACS Test Year Savings	<b>\$2,830,220</b>	[10]

**TABLE 2  
Year 1 - Discount Leakage**

<u>Volume Block</u>	<u>Incremental Volume</u>	<u>Discount</u>	<u>Discount Leakage</u>	<u>Volume E</u>
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[a]	[1]	[b]	[2] = [1b] - [1a]	[3]	[4] = [2] * [3]	[a]	[1]
405,000,000	to	435,000,000	30,000,000	\$0.025	\$750,000	405,000,000	to
435,000,001	to	465,000,000	29,999,999	\$0.030	\$900,000	435,000,001	to
465,000,001	to	490,000,000	24,999,999	\$0.035	\$875,000	465,000,001	to
490,000,001	to	497,630,513	7,630,512	\$0.040	\$305,220	490,000,001	to
515,000,001	to			\$0.045	\$0	515,000,001	to
<b>Total</b>					<b>\$2,830,220</b>		
Difference - ACS Savings and Discount Leakage					\$0.054455		

Attachment to Interrogatory  
OCA/USPS-T1-28  
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**TABLE 1 (Years 1-3)**

Notes & Sources

- [1] USPS-T-1 (Ayub), Appendix A, page 1
- [2] USPS-T-1 (Ayub), Appendix A, page 1
- [3] USPS-T-1 (Ayub), Appendix A, page 1
- [4] USPS-T-1 (Ayub), Appendix A, page 1
- [5] USPS-T-1 (Ayub), Appendix A, page 2
- [6] USPS-T-1 (Ayub), Appendix A, page 2
- [7] = [6] / ([5] + [6])
- [8] = ([1] - [2]) \* [3] \* [4] \* [7]
- [9] = Table 2 [1b]
- [10] = [8] \* [9]

**TABLE 2 (Years 1-3)**

Notes and Sources:

- [1] Request, Attachment B
- [3] Request, Attachment B

**DISCOVER NSA  
Stop Loss Estimate Model**

**TABLE 1  
Year 2 - ACS Related Savings**

Manual Letter Returns Unit Cost	\$0.57
Electronic Letter Returns Unit Cost	\$0.36
Discover Return Rate - Solicitation Mail	9.3%
Address Change Service (ACS) Success Rate	85%
Discover TYBR Customer Mail Volume	290,000,000
Discover TYBR Solicitation Mail Volume	156,000,000
Solicitation Mail % of TYBR Volume	34.98%
Discover ACS Unit Cost Savings	\$0.00598120
Discover TYBR Equilibrium Volume	501,928,341
Total ACS Second Year Savings	<b>\$3,002,134</b>

**TABLE 2  
Year 2 - Discount Leakage**

<u>Block</u>	<u>Incremental Volume</u>	<u>Discount</u>	<u>Discount Leakage</u>
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**DISCOVER NSA  
Stop Loss Estimate Model**

**TABLE 1  
Year 3 - ACS Related Savings**

[1]	Manual Letter Returns Unit Cost
[2]	Electronic Letter Returns Unit Cost
[3]	Discover Return Rate - Solicitation
[4]	Address Change Service (ACS) S
[5]	Discover TYBR Customer Mail Vo
[6]	Discover TYBR Solicitation Mail V
[7]	Solicitation Mail % of TYBR Volum
[8]	Discover ACS Unit Cost Savings
[9]	Discover TYBR Equilibrium Volum
[10]	Total ACS Third Year Savings

**TABLE 2  
Year 3 - Discount Leakage**

**Volume Block**

	[2] = [1b] - [1a]	[3]	[4] = [2] * [3]
[b]			
435,000,000	30,000,000	\$0.025	\$750,000
465,000,000	29,999,999	\$0.030	\$900,000
490,000,000	24,999,999	\$0.035	\$875,000
501,928,341	11,928,340	\$0.040	\$477,134
		\$0.045	\$0

**Total** **\$3,002,134**

Difference - ACS Savings and Discount Leakage \$0.0060996

	[1]	[b]	[2] = [1b] - [1a]
[a]			
405,000,000	to	435,000,000	30,000,000
435,000,001	to	465,000,000	29,999,999
465,000,001	to	490,000,000	24,999,999
490,000,001	to	506,540,893	16,540,892
515,000,001	to		

**Total**

Difference - ACS Savings and Dis

lel

ings

	\$0.60
st	\$0.37
n Mail	9.3%
Success Rate	85%
Volume	285,000,000
Volume	156,000,000
ne	35.37%
	\$0.00629097
ne	506,540,893
	<b>\$3,186,636</b>

ge

<u>Discount</u>	<u>Discount Leakage</u>
-----------------	-----------------------------

[3]            [4] = [2] \* [3]

\$0.025	\$750,000
\$0.030	\$900,000
\$0.035	\$875,000
\$0.040	\$661,636
\$0.045	\$0

\$3,186,636
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Discount Leakage      \$0.0199391



DISCOVER NSA

**TABLE 3**  
**Calculation of Total Stop Loss Estimate**

	<u>Volume</u> [1]	<u>Discount Leakage</u> [2]	<u>Return Cost Savings</u> [3]
Year 1	497,630,513	\$2,830,220	\$2,830,220
Year 2	501,928,341	\$3,002,134	\$3,002,134
Year 3	506,540,893	\$3,186,636	\$3,186,636
			<u>\$9,018,990</u>
Passthrough Percent			95%
TOTAL STOP LOSS ESTIMATE			<b>\$8,568,040</b>

Notes and Sources

[1] & [2] TABLE 2, for the year indicated

[3] TABLE 1, for the year indicated

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**RESPONSE:**

- (a) Not confirmed. Using the approach forwarded in PRC Op. MC2002-2, page 156 para. [8031] of limiting price incentives to 95% of cost savings over the term of the agreement the “stop loss” I calculate to be at \$7,606,602 which is 95% of the total ACS Savings of \$8,006,949 (Appendix A page 11 at line 2).
- (b) Not confirmed. The “stop-loss” cap on the 95% cap on the total dollar value of the price incentives is based only on the quantified savings to the Postal Service. As described in my testimony the Postal Service believes the savings represented are a conservative estimate. Furthermore the “stop-loss” cap does not account for the contribution earned from increased or retained volume due to the price incentives.
- (c) If Discover’s TYBR forecast was 497,630,513 this would represent a volume response of 7.1 times greater than Discover’s projected TYAR forecast of an additional 13,000,000 marketing pieces. In addition the ACS cost-saving projected would be lower.
- (d) Confirmed if TYBR forecast was 501,928,341.
- (e) Confirmed if TYBR forecast was 506,540,893.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-29.** Please refer to your testimony at Appendix A, page 1. Please confirm that the Discover's first-year ACS unit cost saving for solicitation mail is \$0.00568739  $[(\$0.55 - 0.34) * 0.093 * 0.85 * 0.054823]$ , where  $(\$0.55 - 0.34)$  represents the difference between manual return unit costs and electronic return unit costs, 0.09 represents Discover's physical return rate, 0.85 represents the ACS success rate, and 0.3459 represents the ratio of Discover's TYBR solicitation mail volume to the sum of Discover's TYBR customer mail and solicitation mail volume. If you do not confirm, please explain.

**RESPONSE:**

Not confirmed. The calculation presented above does not calculate savings per total marketing piece. The chart below provides the Postal Service valuation of what the savings per total marketing pieces would be given Discover TYBR forecast for Year 1:

(1)	156,000,000	TYBR Marketing Volume
(2)	9.30%	Return Rate
(3)	14,508,000	Return Volume (1)*(2)
(4)	85.00%	ACS Success Rate
(5)	12,331,800	Number of physical returns eliminated
(6)	\$2,589,678	ACS Savings $(\$0.55 - \$0.34) * (5)$
(7)	\$0.0166	Savings per marketing pieces (6) / (1)

It is important to note that even at higher or lower marketing volume levels that the savings of \$0.019 cents does not change.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-30.** Please refer to your response to OCA/USPS-T1-5.

- (a) Please confirm that there are exogenous factors that can affect the Before Rates (BR) volumes of marketing mail. If you do not confirm, please explain.
- (b) Please confirm that there are exogenous factors that can affect the AR volumes of marketing mail. If you do not confirm, please explain.
- (c) If your response to parts (a) and (b) of this interrogatory is in the affirmative, please identify and describe such exogenous factors.
- (d) In your response to OCA/USPS-T1-5(a) you state:

The list of exogenous factors that could increase or decrease statement/operations mail is endless but as described in part (b) the Postal Service believes the threshold adjustment mechanism addresses these variables.

Please identify and explain the specific adjustment mechanism of the Discover NSA and proposed DMCS that explicitly recognizes and attempts to address the existence of exogenous variables as they relate to *future* marketing mail volumes.

**RESPONSE:**

- (a) Confirmed that Discover has provided a forecast that they believe represents the best available future volume projection, based on available data. The effect of any exogenous factors on Before Rates volume forecasts would have the same effect on After Rates volume forecasts (prior to consideration of the price incentives).
- (b) Confirmed that the any exogenous factor (not including the price incentives) that affects the After Rates volume forecast will also affect the Before Rates volume forecast.
- (c) There are a variety of macro and micro economic factors that affect a company's decision making process in developing their mailing strategies.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
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These variables include factors such as interest rates, delinquency rates, response rates, competitive landscapes, company growth strategies, and production costs.

- (d) It is not clear that any exogenous factors, including those listed in response to part (c), pose a risk to the success of the NSA. The relevant risks arise, not from the possibility that Before Rates volumes will be higher or lower than projected, or that After Rates volumes will be higher or lower than projected, but from the possibilities that the *differential* between After Rates and Before Rates volumes will be smaller than projected. The issue of Before Rates volumes being lower than projected is mitigated by the ACS cost savings. If Before Rates volumes are higher than projected, it is probable that the exposure (or "discount leakage") was underestimated. However, by that same token, the projected ACS cost saving will also have been underestimated. Please see OCA/USPS-T1-6.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-31.** Please refer to your response to OCA/USPS-T1-6(b).

Please provide and explain the Excel spreadsheets used to derive the table included with your response.

**RESPONSE:**

The table in my response to OCA/USPS-T1-6(b) provides an estimate of the value of the NSA if the Before Rates forecast of marketing volume were to change by the values presented in the column “% Change in Marketing Volume.”

For example, a -20% change indicates that marketing volume would base all calculations on a Before Rates forecast of 124,800,000  $((1-.20)*156,000,000)$ . In addition, it assumes that the After Rates marketing mail volume shows no increase in response to the price incentives, which is the absolute minimum value for the After Rates forecast. The chart also assumes constant marketing volumes for all three years of the agreement.

Please see the following spreadsheets.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-32.** Table 1 of this interrogatory summarizes the mean, standard deviation, and coefficient of variation for monthly pieces mailed by Discover Financial Services based on data provided in the Direct Testimony of Karin Giffney, DFS-T-1, and in OCA/DFS-T1-5. Similar data are presented for Capital One, based on information presented in the Capital One NSA case, MC2002-2. The monthly data that provide the basis for the calculations of the statistics for Discover Financial Services are summarized in Table 2. The monthly data that provide the basis for the calculations of the statistics for Capital One are presented in Table 3. The data and calculations are also provided in the file DFSCV.xls. Please confirm that for First-Class Solicitation Mail the coefficient of variation for Discover is 0.61; that for Standard Mail the coefficient of variation for Discover is 0.33; and that for First-Class Solicitation Mail the coefficient of variation for Capital One is 0.35. If you do not confirm, please explain your answer in detail.

**Table 1****Millions of Pieces per Month Mailed by Type of Mailing**

	<b>FC Customer Mail</b>	<b>FC Solicitation Mail</b>	<b>Total FC Mail</b>	<b>Standard Mail</b>
<b>Discover</b>				
<b>Mean</b>	26.1	14.7	40.9	47.3
<b>Standard Deviation</b>	1.3	9.1	9.4	15.6
<b>Coefficient of Variation</b>	0.05	0.61	0.23	0.33
<b>Capital One</b>				
<b>Mean</b>	34.2	70.5	104.5	54.0
<b>Standard Deviation</b>	10.9	24.7	30.7	34.3
<b>Coefficient of Variation</b>	0.32	0.35	0.29	0.64

**Notes**

Discover: First-Cales source data from December 99 through December 03 by month.

Discover: Standard Mail source data from December 2000 through November 03 by month.

Capital One: All source data from October 98 through September 02 by month.



Table 2

	Discover: Monthly Mailings			Total FC Mail
	Standard Mail	Marketing Mail	Operations Mail	
Dec-99	46,185,374	10,983,803	26,019,712	37,003,515
Jan-00	21,201,659	4,442,905	24,656,256	23,099,161
Feb-00	55,253,673	11,560,124	25,283,389	36,843,513
Mar-00	42,455,983	47,080,329	24,889,656	71,969,985
Apr-00	65,833,173	8,880,749	23,954,905	32,835,664
May-00	54,360,690	2,971,024	24,590,695	27,561,719
Jun-00	67,842,744	8,463,656	24,662,650	33,126,336
Jul-00	62,997,819	14,718,654	24,938,017	39,656,671
Aug-00	85,110,470	13,616,338	25,409,691	39,026,019
Sep-00	71,542,368	9,875,462	24,947,667	34,823,129
Oct-00	68,523,453	10,689,321	26,131,086	36,820,407
Nov-00	56,233,554	16,934,257	27,833,898	44,768,155
Dec-00	62,836,837	10,656,050	25,620,543	36,276,593
Jan-01	35,036,900	12,392,639	25,360,153	37,752,792
Feb-01	64,221,153	24,068,360	25,875,912	49,944,272
Mar-01	46,507,548	13,240,232	25,368,388	38,608,620
Apr-01	52,261,978	10,895,366	25,409,041	36,304,407
May-01	46,032,444	5,054,920	25,649,428	30,704,348
Jun-01	57,508,640	14,101,764	25,297,673	39,399,457
Jul-01	45,641,185	10,907,850	25,252,916	36,160,766
Aug-01	66,524,211	21,055,416	25,787,691	46,843,107
Sep-01	51,107,780	18,782,428	25,844,965	44,627,393
Oct-01	28,632,214	38,849,619	26,495,123	65,344,742
Nov-01	34,829,111	29,225,728	27,236,967	56,462,695
Dec-01	26,124,243	11,036,124	27,821,835	38,857,959
Jan-02	70,393,581	20,579,413	27,831,948	48,411,351
Feb-02	40,303,056	18,734,310	27,512,108	46,246,418
Mar-02	27,402,433	9,918,058	28,125,220	38,043,278
Apr-02	33,946,497	9,295,077	27,671,148	36,966,225
May-02	30,870,973	18,309,872	27,316,428	45,626,300
Jun-02	64,328,566	28,061,863	25,995,405	54,057,268
Jul-02	23,206,401	431,865	28,180,136	26,612,001
Aug-02	41,956,362	10,662,159	23,316,130	38,978,289
Sep-02	45,804,975	14,463,979	28,238,399	42,702,378
Oct-02	52,597,759	20,727,322	28,637,176	49,364,498
Nov-02	42,724,616	33,618,431	28,127,623	61,746,054
Dec-02	37,622,732	28,357,215	26,774,983	55,132,198
Jan-03	61,877,181	13,427,613	27,367,551	40,795,264
Feb-03	60,621,690	10,163,281	26,098,149	36,261,430
Mar-03	48,819,532	11,568,258	26,103,841	37,672,099
Apr-03	49,460,915	11,724,500	26,281,431	38,005,931
May-03	44,447,020	9,425,696	26,833,247	36,259,943
Jun-03	33,634,169	7,291,696	25,862,033	33,153,729
Jul-03	31,186,613	8,208,639	25,654,287	33,862,825
Aug-03	33,295,819	8,049,412	25,052,195	33,101,608
Sep-03	33,408,274	8,993,174	24,383,001	33,376,175
Oct-03	34,490,170	8,677,867	24,626,432	33,504,319
Nov-03	14,921,093	20,124,732	23,355,150	43,479,882
Dec-04		11,131,530	24,805,590	35,937,120
Mean	47,339,826	14,747,554	26,111,999	40,859,553
Std Dev	15,611,285	9,066,121	1,315,233	9,376,320
Coefficient of Variation	0.33	0.61	0.05	0.23

Source: Standard Mail MC2004-4, OCA/DFS-T1-5  
 First-Class Mail MC2004-4, DFS-T-1

Table 3

Date	Customer Mail	Capital One: Monthly Mailings		
		Solicitation FC Mail	Total FC Mail	Standard Mail
Oct-98	20,000,000	64,312,211	84,312,211	2,279,673
Nov-98	20,000,000	84,513,668	104,513,668	1,248,749
Dec-98	20,000,000	70,330,103	90,330,103	698,236
Jan-99	20,093,585	48,713,996	68,807,581	4,704,266
Feb-99	18,936,302	51,911,135	70,847,437	6,815,494
Mar-99	21,429,647	101,113,631	122,543,478	5,442,520
Apr-99	20,237,967	53,185,873	73,423,840	21,569,499
May-99	21,493,755	42,764,936	64,276,691	21,335,663
Jun-99	21,315,898	51,911,418	73,227,316	15,785,065
Jul-99	22,366,963	82,763,889	105,130,852	27,986,822
Aug-99	22,218,406	45,709,167	67,927,573	66,617,101
Sep-99	22,283,276	47,420,011	69,703,287	42,448,557
Oct-99	23,753,037	78,771,652	102,524,689	30,248,391
Nov-99	24,924,804	99,036,307	123,961,111	15,345,511
Dec-99	28,323,271	56,759,404	85,082,675	7,921,155
Jan-00	25,733,873	90,404,633	116,138,506	56,792,786
Feb-00	24,438,019	35,453,537	59,891,556	34,437,081
Mar-00	27,320,181	53,057,033	80,377,214	39,614,873
Apr-00	29,480,138	38,646,756	68,326,894	28,331,357
May-00	30,351,077	53,642,857	83,993,934	50,397,191
Jun-00	30,470,815	82,813,549	113,284,364	55,393,585
Jul-00	30,068,221	63,641,402	93,709,623	47,904,323
Aug-00	32,449,688	48,333,024	80,782,712	66,828,624
Sep-00	31,289,392	52,860,401	84,149,793	105,033,143
Oct-00	35,458,669	36,680,749	72,139,418	119,564,729
Nov-00	36,222,564	69,978,222	106,200,786	82,909,126
Dec-00	38,333,630	69,555,071	107,888,701	32,121,903
Jan-01	37,538,604	71,609,132	109,147,736	94,006,455
Feb-01	37,228,200	67,678,601	104,906,801	73,448,261
Mar-01	40,595,396	79,707,394	120,302,790	85,245,080
Apr-01	39,584,216	53,734,153	93,318,369	93,752,823
May-01	39,613,572	68,616,452	108,430,024	94,422,524
Jun-01	40,094,283	50,499,839	90,594,122	63,251,136
Jul-01	43,936,373	77,390,674	121,327,047	70,807,874
Aug-01	41,780,602	61,920,684	103,701,286	101,295,653
Sep-01	40,206,176	81,359,208	121,565,384	69,564,731
Oct-01	46,379,476	109,959,062	156,338,538	88,010,149
Nov-01	42,756,595	123,429,831	166,186,426	88,765,050
Dec-01	49,050,084	114,868,000	163,918,084	25,136,785
Jan-02	49,347,570	111,473,290	160,820,860	105,436,265
Feb-02	46,416,492	97,894,068	144,310,560	83,400,395
Mar-02	50,472,716	118,835,045	169,307,761	86,376,653
Apr-02	50,248,542	98,176,516	148,425,058	97,144,193
May-02	51,306,612	121,404,738	172,711,350	76,604,133
Jun-02	48,162,673	56,909,685	105,072,358	54,916,252
Jul-02	48,732,181	36,351,765	85,083,946	41,894,720
Aug-02	50,000,000	43,000,000	93,000,000	
Sep-02	50,000,000	64,000,000	114,000,000	
Mean	34217573.77	70490061.92	104707635.69	53983799.02
Std Dev	10894158.29	24733365.74	30672788.78	34327313.76
Coefficient of Variation	0.32	0.35	0.29	0.64

Source: COS-T-2, MC2002-2, Direct Testimony of Stuart Elliott, Exhibit 2  
MC2002-2, OCA/COS-T2-6.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**RESPONSE:**

I confirm the calculations as presented.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-33.** Please refer to the table below, entitled APPENDIX A, page 4, (REVISED BY OCA), which contains revisions to the Discover Model at Appendix A, page 4 of your testimony. Please confirm that the table entitled APPENDIX A, page 4, (REVISED BY OCA) is an alternative presentation of the Discover Model that separates various calculations in Appendix A at page 4 of your testimony. If you do not confirm, please explain and show all calculations.

(1)	Discover Marketing Mail Return Percentage	8.3%
(2)	Discover Statement Mail Return Percentage	1.23%
(3)	Average First-Class Return Percentage	0.3%
(4)	Discover Statement Mail Volume BEFORE RAATES	295,000,000
(5)	Discover Statement Mail Volume AFTER RAATES	295,000,000
(6)	Discover Marketing Mail Volume BEFORE RAATES	158,000,000
(7)	Discover Marketing Mail Volume AFTER RAATES	90,587
(8)	Electronic Return Unit Cost	\$0.343
(9)	Address Change Service (ACS) Success Rate	68.0%
(10)	Contingency Factor =	1.03

USPS ORIGINAL COLUMNS (A-yub)

DOCKET NO. R2001-1 PRC FIGURES - DISCOVER MAIL MIX

(11) (12)

Rate Category

FIRST-CLASS MAIL LETTERS

NOTES (to OCA's portion of table):

NOTES (to USPS' portion of table):

[illegible]

(13) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) \* (Statement Mail Return Forecast - USPS FCM Avg Return Rate) /

(14) (10) + (13). NOTE: column (10) in Appendix A, page 4 is the same as column (11) in this table.

(ACS SUBJECTS HAVE - EFFECTIVE LEADER ROLLS IN UNIT COST + 1 : ACS SUBJECTS HAVE - MANAGERIAL LEADER ROLLS IN UNIT COST)

USPS FCM Avg. Return Rate<sup>a</sup> (Manual Letter Returns Unit Cost) • Electronics Letter Returns Unit Cost<sup>b</sup> • ACS Success Rate<sup>c</sup>

(14) \* Contingency Factor (Assumptions)

Discover NSA Model

1900 1917 1925

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**RESPONSE:**

Confirmed that the calculations present a modified version of the  
calculations on page 4 of Appendix A to my testimony.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-34.** Please refer to the table below, entitled APPENDIX A, page 5, (REVISED BY OCA), which contains revisions to the Discover Model at Appendix A, page 5 of your testimony. Please confirm that the table entitled APPENDIX A, page 5, (REVISED BY OCA) is an alternative presentation of the Discover Model that separates various calculations in Appendix A at page 5 of your testimony. If you do not confirm, please explain and show all calculations.

# APPENDIX A, page 5 (REVISED BY OCA)

## Discover Model (Marketing Mail)

Negotiated Service Agreement

Appendix A, page 5

Discover Marketing Mail Return Percentage	9.3%	(1)
Discover Statement Mail Return Percentage	0.3%	(2)
Average Presort Letters Return Percentage	1.23%	(3)
Discover Statement Mail Volume BEFORE RATES	295,000,000	(4)
Discover Statement Mail Volume AFTER RATES	295,000,000	(5)
Discover Marketing Mail Volume BEFORE RATES	156,000,000	(6)
Discover Marketing Mail Volume AFTER RATES	169,000,000	(7)
Manual Returns Unit Cost	\$0.551	(8)
Electronic Returns Unit Cost	\$0.343	(9)
Address Change Service (ACS) Success Rate	85.0%	(10)
Contingency Factor	1.03	

### OCA's REVISED COLUMNS

#### DOCKET NO. R2001-1 PRC FIGURES - DISCOVER MAIL MIX

Rate Category	(11) Discover TY 2004 Total Unit Cost (Dollars)	(12) Discover FY 2003 Mail Volume (Pieces)	(13) Discover FY 2003 Mail Volume (Percent)	(14) Discover BR 2004 Adjustment for Average Returns Unit Cost (Dollars)	(15) Discover BR 2004 Marketing Total Unit Cost w/o Average Returns (Dollars)	(16) Discover BR 2004 Adjustment for Marketing Returns Unit Cost (Dollars)	(17) Discover BR 2004 Marketing Total Returns Adjusted Unit Cost (Dollars)	(18) Discover AR 2004 Adjustment for Marketing Returns Unit Cost (Dollars)	(19) Discover AR 2004 Marketing Total Returns Adjusted Unit Cost (Dollars)
Nonautomation Presort Letters	0.254	54,986	0.0%						
Automation Presort Letters									
Automation Mixed AADC	0.123	1,235,576	0.9%						
Automation AADC	0.111	3,554,645	2.6%						
Automation 3-Digit	0.108	82,154,568	59.8%						
Automation 5-Digit	0.095	49,987,987	36.4%						
Automation Carrier Route	0.107	459,875	0.3%						
WEIGHTED AVERAGE / TOTAL	0.103	137,447,635	100.0%	\$0.0068	\$0.0964	\$0.0513	\$0.148 0.14768543	\$0.0348	\$0.131 0.13124303

### USPS' ORIGINAL COLUMNS (Ayub)

(13)	(14)	(15)	(18)
Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
0.0445	0.148 0.14768543 (17)	0.0280	0.131 0.13124303 (18)
Total Unit Cost Estimates, including Contingency =			
	0.151		0.135

NOTES (to OCA's portion of table):

- (1) USPS-T-1 (Plunkett), Appendix A, page 1
- (2) USPS-T-1 (Plunkett), Appendix A, page 1
- (3) USPS-T-1 (Plunkett), Appendix A, page 1
- (4) USPS-T-1 (Plunkett), Appendix A, page 2
- (5) USPS-T-1 (Plunkett), Appendix A, page 2
- (6) USPS-T-1 (Plunkett), Appendix A, page 2
- (7) USPS-T-1 (Plunkett), Appendix A, page 2
- (8) USPS-T-1 (Plunkett), Appendix A, page 1
- (9) USPS-T-1 (Plunkett), Appendix A, page 1
- (10) USPS-T-1 (Plunkett), Appendix A, page 1
- (11) USPS-T-1 (Plunkett), Appendix A, page 5, Col. (10)
- (12) USPS-T-1 (Plunkett), Appendix A, page 5, Col. (11)
- (13) USPS-T-1 (Plunkett), Appendix A, page 5, Col. (12)
- (14) (7) \* (3)
- (15) (11) - (14)
- (16) ((1) \* (6) \* (8)) / (6)
- (17) (15) \* (16)
- (18) (((1) \* (((10) \* (9)) + ((1 - (10)) \* (8)))) \* (7)) / (7)
- \*\*\* (15) \* (19)

NOTES (to USPS' portion of table):

- (13) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
- (14) (10) \* (13). NOTE: column (10) in Appendix A, page 4 is the same as column (11) in this table.
- (15) ((ACS Success Rate \* Electronic Letter Returns Unit Cost \* (1 - ACS Success Rate) \* Manual Letter Returns Unit Cost) \* After Rates Statement Mail \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate)) / After Rates Statement Mail - USPS FCM Avg. Return Rate \* (Manual Letter Returns Unit Cost - Electronic Letter Returns Unit Cost) \* ACS Success Rate
- (16) (10) \* (15). NOTE: column (10) in Appendix A, page 4 is the same as column (11) in this table.
- (17) (14) \* Contingency Factor (Assumptions)
- (18) (18) \* Contingency Factor (Assumptions)





RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**RESPONSE:**

Confirmed that the calculations present a modified version of the calculations on page 5 of Appendix A to my testimony.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T1-35.** Please refer to your response to OCA/USPS-T1-12, which states that the

Postal Service's understanding of the 'stop-loss' provision is that the 'stop-loss' is equal to 95% of the ACS cost savings over the term of the agreement. The ACS cost savings are presented in Appendix A, page 11, line (2), of my testimony is \$8,006,949.

Also, please refer to Table 8-2 from PRC Op. MC2002-2, reproduced as an attachment to this interrogatory.

- a. Please confirm that Table 8-2 presents the Commission's methodology for calculating the "ACS Related Savings" used in estimating the stop-loss for the Capital One NSA. If you do not confirm, please explain.
- b. Please confirm that the Commission did not use in its development of Table 8-2 the Return Cost Savings figure (\$13,094,000) calculated by witness Crum (USPS-T-3) in Attachment B, page 2 of his testimony in Docket No. MC2002-2. If you do not confirm, please explain.
- c. Please confirm that, in preparing your response to OCA/USPS-T1-12 as it relates to the Discover NSA, you did not use the Commission's methodology as presented in Table 8-2 to calculate "the 'stop-loss' [that] is equal to 95% of the ACS cost savings over the term of the agreement." If you do not confirm, please explain and calculate the stop-loss that is equal to 95% of the ACS cost savings over the term of the agreement using the same methodology and format as presented by the Commission in Table 8-2. Provide citations to all sources.